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DECONSTRUCTING CORPORATE GOVERNANCE: THE MECHANICS OF TRUSTING

BY RENÉ REICH-GRAEFE*

ABSTRACT

The phenomenon of trust among firm participants is a much neglected academic inquiry in corporate governance research and the theory of the firm. This Article elaborates on the comparatively small sample of existing legal research on the intersection of trust and corporate governance and tries to interrupt the selective (in-)attention given to the philosophical, psychological, political, sociological, economic, and legal phenomenon that is our individual as well as collective, everyday trust (or distrust) in the functionality and explainability of the world tomorrow in accordance with our preferences of today and our experiences of the past. Trust—as a phenomenon—is a concrete but severely underappreciated reality for the success of corporate investments and the accountability of corporate management. It constitutes part of a complex solution for encouraging investor confidence in the face of absolute decision-making power of corporate directors. Trust efficiently combines and balances otherwise unrestricted managerial power with a robust measure of accountability of corporate management—an entirely elusive measure within the realm of corporate governance law. It thereby provides a sophisticated, yet poorly understood, remedy to the most significant but unresolved academic dilemma in corporate governance theory—namely, the lack of predictive ability of existing microtheoretical models of the firm. This Article primarily discusses trust (and trustworthiness) as a mechanism, not as a virtue. By focusing on the procedural and substantive mechanics of trusting as a phenomenon, this Article explains the cohesive power and low-transaction-cost functionality which is built into successful exercises of trusting for purposes of encouraging and establishing pervasive corporate investments as the rational-choice baseline for voluntary firm participants.

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Vertraeuen ist gut, Kontrolle is besser.
—*German Proverb*[**]

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I. OPENING SKETCHES

In (economic) cooperation, trust ranks second to none.[1] Trust—as a commodity and productive resource[2]—constitutes the magical "lubricant"[3]

[**]"Trust is good, control is better." (translation by author). The proverb may have originated from a similar Russian aphorism: "Trust but verify" (which itself is sometimes attributed further to a 1914 essay by Lenin). *See* TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 50 (Oxford Univ. Press, Inc. 2006); Michael Day, *Toward Distributed Infrastructures for Digital Preservation: The Roles of Collaboration and Trust*, 3 INT'L J. DIGITAL CURATION 15, 21 & n.3 (2008).

[1]*See, e.g.*, KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 23 (1974) ("[Trust] is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word."); EMANUELA TODEVA, BUSINESS NETWORKS: STRATEGY AND STRUCTURE 166 (2006) ("The values of interpersonal trust and affinal reciprocity are universal, and many other people and nations have recognised the practical advantage of reciprocal obligations, against fears of reprisal and of losing functional ties."); Avner Ben-Ner & Louis Putterman, *Trusting and Trustworthiness*, 81 B.U. L. REV. 523, 523 (2001) ("The need to decide whether to trust another party is ubiquitous in business dealings."); John Child, *Trust—The Fundamental Bond in Global Cooperation*, 29 ORG. DYNAMICS 274, 277 (2001) ("Trust is a fundamental component of human relationships throughout the world."); Partha Dasgupta, *Trust as a Commodity*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 49, 51 (Diego Gambetta ed., 1988) ("Trust is of much importance precisely because its presence or absence can have a strong bearing on what we choose to do and in many cases what we *can* do."); William A. Galston, *Trust—But Quantify*, PUB. INTEREST, Winter

and "glue"[4] which, among (corporate) firm participants, efficiently manipulates and controls opportunistic post-investment behavior in order to concentrate and achieve adequate levels of commitment, stability, and autopoietic cohesion within the black-box production function[5] of the modern (corporate) firm. That being said, the phenomenon of trust, as well as its place and function within current models of corporate governance and the firm,[6] are relatively recent subjects of academic interest and inquiry by

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1996, at 129, 129 ("[T]he modern market economy rests on associations of production and exchange . . . . [which] requires, in turn, *trust*, widely distributed.") (reviewing FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY (1995)); Lynn A. Stout, *The Investor Confidence Game*, 68 BROOK. L. REV. 407, 408 (2002) [hereinafter Stout, *Investor Confidence*] ("Investor trust provides the foundation on which the American securities market has been built. Without investor trust, our market would be a thin shadow of its present self."); *see also* Rafael La Porta et al., *Trust in Large Organizations*, 87 AM. ECON. REV. 333, 337 (1997) ("Trust promotes cooperation, especially in large organizations.").

[2]ARROW, *supra* note 1, at 23 ("Trust and similar values, loyalty or truth-telling, . . . are goods, they are commodities . . . ."); Karen S. Cook et al., *Trust Building via Risk Taking: A Cross-Societal Experiment*, 68 SOC. PSYCHOL. Q. 121, 122 (2005) ("[A] trust relation in which one person can expect trustworthy behavior from another becomes a highly valuable commodity."); Dasgupta, *supra* note 1, at 51 ("[T]rust is not dissimilar to commodities such as knowledge or information.").

[3]ARROW, *supra* note 1, at 23 ("Trust is an important lubricant of a social system."); John Ermisch et al., *Measuring People's Trust*, 172 J. ROYAL STAT. SOC'Y (SERIES A: STAT. SOC'Y) 749, 749 (2009) (stating the same); Diego Gambetta, Foreword to TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS ix, x (Diego Gambetta ed., 1988) [hereinafter Gambetta, Foreword] ("[I]n the social sciences . . . scholars . . . allude to [trust] as a fundamental ingredient or lubricant . . . ."); Toko Kiyonari et al., *Does Trust Beget Trustworthiness? Trust and Trustworthiness in Two Games and Two Cultures: A Research Note*, 69 SOC. PSYCHOL. Q. 270, 270 (2006).

[4]Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 425 (1993) [hereinafter Mitchell, *Fairness and Trust*] ("Trust is the glue that binds corporate relationships."); Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 553 (2001) ("Trust is a kind of social glue that allows people to interact at low transaction costs."); *see also* Robert C. Ellickson, *Law and Economics Discovers Social Norms*, 27 J. LEGAL STUD. 537, 540 (1998) ("Much of the glue of a society comes not from law enforcement, as the classicists would have it, but rather from the informal enforcement of social mores by acquaintances, bystanders, trading partners, and others."); René Reich-Graefe, *Deconstructing Corporate Governance: Director Primacy Without Principle?*, 16 FORDHAM J. CORP. & FIN. L. 465, 485-87 (2011) (describing so-called "protolegal variables"—among them, prominently, trust—as "hidden catalysts").

[5]*See, e.g.*, TODEVA, *supra* note 1, at 47 ("The structural perspective [of business network analysis] treats inter-firm relationships very much in an instrumental way – as a 'black box' representing a connection of some sort without specifying what takes place between the connected parties."); Charles R.T. O'Kelley, *The Entrepreneur and the Theory of the Modern Corporation*, 31 J. CORP. L. 753, 757 (2006) (stating the firm is a "black box" in classical and neoclassical perfect competition theory); Walter W. Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RES. ORG. BEHAV. 295, 296 (1990) (describing the paradigm shift developed by Ronald Coase in his groundbreaking 1937 article, R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937), conceiving of the firm as a governing structure, thus, "breaking with orthodox accounts of the firm as a 'black box' production function").

[6]The four main models of corporate governance in today's academic discussion can be labeled as "shareholder primacy," "contractarian," "team production," and "director primacy." *See, e.g.*, Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16

corporate theoreticians.[7] Though the notion of trust—including its foundational ingredients (trustfulness, trustworthiness, and the dichotomous

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TRANSNAT'L LAW. 45, 47-53 (2002) [hereinafter Bainbridge, *Director v. Shareholder*] (discussing shareholder-primacy and director-primacy models); John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Corporations?*, 24 J. CORP. L. 837, 837-43 (1999) (discussing team production models); George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1216-21 (2008) (discussing team-production and director-primacy models); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 646-50 (2006) (discussing shareholder-primacy models); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 537-41 (2006) (discussing shareholder primacy and team production theory); René Reich-Graefe, *Deconstructing Corporate Governance: Absolute Director Primacy*, 5 BROOK. J. CORP. FIN. & COM. L. 341, 361-95 (2011) (discussing and critiquing all four models in detail); J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 315-26 (2010) (discussing all four models as well as "agency theory" and "progressive corporate law theory"). For a more general discussion of those firm models, *see also* Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 832-34 (1999); O'Kelley, *supra* note 5, at 772-76; Steven M.H. Wallman, *Understanding the Purpose of a Corporation: An Introduction*, 24 J. CORP. L. 807, 809-14 (1999).

[7]The beginnings of the law of corporate governance—as a discrete subset of corporate law (or of the law of business organizations more generally) and as an area of research and scholarship in corporate legal theory—can be traced back to two, now classical works: Adolf Berle and Gardiner Means' *The Modern Corporation and Private Property* in 1932 and Frank Knight's *Risk, Uncertainty, and Profit*, in 1921. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT (1921). *See, e.g.*, STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 4-5 (2008) (describing Berle and Means' *The Modern Corporation and Private Property* as "what still may be the most influential book ever written about corporations"); Alice Belcher, *The boundaries of the firm: the theories of Coase, Knight and Weitzman*, 17 LEGAL STUD. 22, 24-25 (1997) (explaining the problem of firm governance under "Knightian uncertainty"); O'Kelley, *supra* note 5, at 756 (describing Knight's *Risk, Uncertainty, and Profit* as "[t]he foremost description of the classic entrepreneur, immediately prior to the Great Depression and now"); Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984) (describing Berle and Means' treatise as the "last major work of original scholarship" in corporate governance). On the legacy of Berle and Means and their groundbreaking research, *see generally* Kelli A. Alces, *Revisiting Berle and Rethinking the Corporate Structure*, 33 SEATTLE U. L. REV. 787, 787-90 (2010) (describing how "Berle's work is relevant nearly eighty years after its publication"); William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 738 (2001) ("Berle and Means retain an enviable place at the forefront of policy discussion in a field where even a highly successful academic contribution rarely has a shelf life exceeding ten years."); William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and* The Modern Corporation, 34 J. CORP. L. 99, 101 (2008) [hereinafter Bratton & Wachter, *Corporatist Origins*] (describing the "Berle-Dodd debate" as the "famous, precedent-setting debate of the 1930s"); William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of* The Modern Corporation*'s Last Chapter*, 33 SEATTLE U. L. REV. 849, 849-50 (2010) (discussing *The Modern Corporation and Private Property*'s "most famous sequence, its last chapter"); Charles R. T. O'Kelley, *Berle and the Entrepreneur*, 33 SEATTLE U. L. REV. 1141, 1141-44 (2010) (discussing both the works of Berle and Knight); Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247, 1248 (2010) (stating that "whatever came before, corporate governance *really* began with Berle and Means").

In contrast thereto, sporadic academic interest in the intersection of corporate governance processes of trusting and entrusting)—appears to provide an immensely important contribution to solving the fundamental principal-agent problem[8] of efficient (and maybe even just)[9] governance of the modern Berle-Means

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and trust has, for the most part, been an integral part of the so-called "law and norms" literature which fully emerged in legal academia in the 1990s after Robert Ellickson's groundbreaking study, ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991). *See, e.g.*, Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 121 (2006). For a discussion of the "law and norms" literature, *see, e.g.*, *id.* at 121-24; Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338, 343-51 (1997); Lawrence E. Mitchell, *Understanding Norms*, 49 U. TORONTO L.J. 177, 193-96 (1999). For a more precise overview of the academic literature on law (including corporate law and, included therein, corporate governance) and social norms (including trust), see *infra* notes 174-81 and accompanying text.

[8]By this, I mean the fundamental agency problem of managerial primacy (*i.e.*, the allocation of control with, and the resultant *discretion* of, corporate decision makers) and shareholder/stakeholder primacy (*i.e.*, the allocation of controlling property and/or contract rights with, and the resultant *accountability* to, specific firm participants). *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATE LAW 75 (2d ed. 2009) [hereinafter BAINBRIDGE, CORPORATE LAW]; STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 207 (2002) [hereinafter BAINBRIDGE, CORPORATION LAW AND ECONOMICS]; Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 84-85 (2004); Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743, 743 (1999) [hereinafter Blair & Stout, *Introduction*]; Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 524-25 (1992); Darian M. Ibrahim, *Individual or Collective Liability for Corporate Directors?*, 93 IOWA L. REV. 929, 947-48 (2008); Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185, 188-89 (Lawrence E. Mitchell ed., 1995) [hereinafter Mitchell, *Trust. Contract. Process.*]; Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 740-48 (1997); *see also* Rudolf Richter, *The New Institutional Economics: Its Start, Its Meaning, Its Prospects*, 6 EUR. BUS. ORG. L. REV. 161, 174-75, 179 (2005) (discussing transaction cost economics and stating that its central problem is ex-post opportunism).

[9]Macrotheoretical concerns of social costs, distributive justice, and political legitimacy in the governance of the corporate endeavor are inevitable. *Cf.* Ronald J. Gilson & Reinier Kraakman, *Clark's Treatise on Corporate Law: Filling Manning's Empty Towers*, 31 J. CORP. L. 599, 604 n.21 (2006) (discussing "the [supposedly] ugly problem of political legitimacy" in corporate law); Henry Hansmann & Reinier Kraakman, *What is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 18 (Reinier Kraakman et al. eds., 2004) ("As a normative matter, the overall objective of corporate law—as of any branch of law—is presumably to serve the interest of society as a whole."); Douglas A. Kysar, *Sustainability, Distribution, and the Macroeconomic Analysis of Law*, 43 B.C. L. REV. 1, 22 (2001) ("More than one commentator has speculated that the disappearance of limits in macroeconomics serves as a theoretical expedient to avoid difficult questions of distribution."); Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. L. 869, 870 (1999) [hereinafter Mitchell, *Trust and Team Production*] (describing the understanding of corporate organization in terms of team production not only as a "tale . . . of economics alone" but also as "to conceive of the corporation as a political institution" and "as a social institution"); Randall S. Thomas, *What is Corporate Law's Place in Promoting Societal Welfare?: An Essay in Honor of Professor William Klein*, 2 BERKELEY BUS. L.J. 135, 135 (2005) ("It strikes me that the overall goal of good corporate law should be to assist private parties to create wealth for themselves and the economy in a manner that does not inflict uncompensated negative externalities upon third parties."); Wallman, *supra* note 6, at 809-10 (concluding that corporate governance must be aimed at maximizing "societal wealth over the long

corporation,[10] corporate law scholarship, which addresses—*explicitly and squarely*—the crucial, central relevance and functionality of trust relationships within the academic field of corporate governance law, can still be counted on the fingers of two hands (and, thus, be collected and "anthologized" within a single footnote).[11]

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term"); Lord Wedderburn, F.B.A., *Trust, Corporation and the Worker*, 23 OSGOODE HALL L.J. 203, 204 (1985) ("Property and power cannot avoid the problem of legitimacy."); *see also* Reich-Graefe, *supra* note 4, at 488-501 (analyzing the macrotheoretical realm of corporate governance in detail).

[10]The legal and economic nature of the publicly held corporation, with widely disbursed share ownership and an almost complete separation of ownership and control, was first thoroughly analyzed and established as a distinct subject of corporate law study by Adolf Berle and Gardiner Means. BERLE & MEANS, *supra* note 7, at 84-90, 119-25. *But see* KNIGHT, *supra* note 7, at 291 ("T[he] typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control."). Hence the moniker "Berle-Means corporation" was established in order to designate such type of public corporation, as well as the term "Berle-Means Paradigm" in order to describe the intellectual framework that has informed the study of large publicly-held corporations ever since. *See, e.g.*, Bratton, *Berle and Means Reconsidered*, *supra* note 7, at 737; O'Kelley, *supra* note 5, at 759; David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1329 (1998).

[11]Corporate law scholarship that is *explicitly and squarely on topic* is found in Alice Belcher, *Trust in the Boardroom*, 16 GRIFFITH L. REV. 151, 161 (2007); Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 433, 436 (2001) [hereinafter Blair & Stout, *Director Accountability*]; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1780-1807 (2001) [hereinafter Blair & Stout, *Behavioral Foundations*]; Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 255-73 (2006); Joan MacLeod Heminway, *Sex, Trust, and Corporate Boards*, 18 HASTINGS WOMEN'S L.J. 173, 187-92 (2007); Mitchell, *Fairness and Trust*, supra note 4, at 430-36; Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse*, 87 WASH. U. L. REV. 115, 136-61 (2009); Stout, *Investor Confidence*, *supra* note 1, 415-20.

Additional (corporate) legal scholarship that, at least, *explicitly explores certain aspects* of the intersection of trust and corporate governance—in particular, trust and the fiduciary duties of corporate directors—can also be found, for example, in 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, 245-58 (2006); Bruce Chapman, *Trust, Economic Rationality, and the Corporate Fiduciary Obligation*, 43 U. TORONTO L.J. 547, 550-53 (1993); Ronald J. Colombo, *Trust and the Reform of Securities Regulation*, 35 DEL. J. CORP. L. 829, 856-65 (2010); Janice Dean, *Trust and Corporate Communications*, 4 J. CORP. L. STUD. 465, 476-83 (2004); Richard A. Epstein, *Contract and Trust in Corporate Law: The Case of Corporate Opportunity*, 21 DEL. J. CORP. L. 5, 9-13 (1996); Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1785-95 (2006); R. William Ide III & Douglas H. Yarn, *Public Independent Fact-Finding: A Trust-Generating Institution for an Age of Corporate Illegitimacy and Public Mistrust*, 56 VAND. L. REV. 1113, 1132-41 (2003); Lawrence E. Mitchell, *The Importance of Being Trusted*, 81 B.U. L. Rev. 591, 614-17 (2001) [hereinafter Mitchell, *Being Trusted*]; Mitchell, *Trust and Team Production*, *supra* note 9, at 876-87; Mitchell, *Trust. Contract. Process.*, *supra* note 8, at 190-96; Ribstein, *supra* note 4, at 577-85; Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33, 38-42, 45-46 (Alan J. Auerbach ed., 1988); Frederick Tung, *The Puzzle of Independent Directors: New Learning*, 91 B.U. L. REV. 1175, 1175-

This current status quo of rather absent corporate law scholarship,[12] which embraces the inextricably "diffuse,"[13] "fuzzy,"[14] "messy,"[15] "soft and mushy,"[16] "muddy,"[17] and "slippery"[18] intersecting tissue of trust and corporate governance, is quite surprising[19] in, at least, *seven* different dimensions.

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77 (2011); Wedderburn, *supra* note 9, at 212-32. For a complete schematic overview of the academic literature on law (including corporate law and, included therein, corporate governance) and social norms (including trust), see *infra* notes 174-81 and accompanying text.

[12]As a (rather crude, since over- as well as under-inclusive) means for comparison of academic interest in corporate law scholarship, a law review title search of HeinOnline's Law Journal Library database, conducted on Nov. 16, 2012 and searching for "*((title:(corporate) AND title:(governance))*" resulted in 1,116 articles. Additional title searches of the same database on the same day, searching for "*((title:(corporate) AND title:(law))*", "*((title:(corporation) AND title:(law))*", "*((title:(corporations) AND title:(law))*", "*((title:(company) AND title:(law))*", and "*((title:(companies) AND title:(law))*" netted 1,555, 734, 429, 778, and 262 matching articles, respectively.

[13]Epstein, *supra* note 11, at 10 ("At some point concrete rules will have to give way, or at least share the stage, with other rules of a more general and diffuse nature."); Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J.L. & ECON. 453, 469 (1993) ("If calculative relations are best described in calculative terms, then diffuse terms, of which trust is one, that have mixed meanings should be avoided when possible."). *See also* J. David Lewis & Andrew Weigert, *Trust as a Social Reality*, 63 SOC. FORCES 967, 972 (1985).

[14]Mitchell, *supra* note 7, at 203 ("Norms are fuzzy because people are fuzzy and life is fuzzy."); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1699 (1996) ("Norms are fuzzy."); *see also* Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 333 (1999); Denise M. Rousseau et al., *Not So Different After All: A Cross-Discipline View of Trust*, 23 ACAD. MGMT. REV. 393, 394 (1998).

[15]Blair & Stout, *Director Accountability*, *supra* note 11, at 436 ("As a solution to the contracting problems associated with team production, the mediating board is obviously messy."); Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 652 (2002) [hereinafter Rock & Wachter, *Dangerous Liasions*] ("An 'ordinary prudence' or 'reasonable person' duty of care, if taken seriously, creates an impossible mess for corporate law."); Tung, *supra* note 11, at 1178 ("[S]ocial incentives [motivating, for example, independent directors] are messy; they are hard to measure or analyze rigorously.").

[16]Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1759.

[17]Siebecker, *supra* note 11 at 148; *see also* Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603, 1607 (2000). *Cf.* ELLICKSON, *supra* note 7, at 147 & n.46 (noting that Arthur Leff, in casual conversation, labeled "law-and-economics as a desert and law-and-society as a *swamp*") (emphasis added).

[18]Posner, *supra* note 14, at 1699 ("The concept of a 'norm' is slippery, and scholars use it in different ways."); Lynn A. Stout, *On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite* Homo Economicus *to Join Your Board)*, 28 DEL. J. CORP. L. 1, 9 (2003) [hereinafter Stout, *Proper Motives*] ("[I]f we want to understand how boards of directors work, we need to develop a better understanding of the sorts of internal pressures encompassed by terms like 'honor,' 'integrity,' 'trustworthiness,' and 'responsibility.' Yet how can we gain a firm grasp on such soft and slippery concepts?"); *see also* Gambetta, Foreword, *supra* note 3, at ix (referring to "trust" as an "elusive notion"); Lee, *supra* note 6, at 575 ("The terms 'morality' and 'justice' may raise red flags for readers skeptical of deontology and inclined toward consequentialism.").

[19]Unless it may be claimed that *because* of all the "diffuseness, fuzziness, messiness and slipperiness," the lack of robust research is *not* surprising (*i.e.*, academics may simply "get real

First—and *most generally* speaking—*every* economic transaction, *every* economic collective action and cooperative activity, has an indispensable element of trust built into its very core—an observation already made by Kenneth Arrow four decades ago: "Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. [M]uch of the economic backwardness in the world can be explained by the lack of mutual confidence . . . ."[20]

Second—and relative to the phenomenon of trust in the realm of fiduciary relationships in general—it is commonly understood that such relationships are "service relationships, in which fiduciaries provide *to entrustors* services that public policy encourages."[21] In other words, the phenomenon of trust is functionally "embedded"[22] and centrally instrumental as an "extra-legal"[23] (or protolegal)[24] variable within a certain type of

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'squirrelly'" about these intersecting issues and are unwilling to even touch them in order to keep their research/models/theories pure and clean). Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1759; Lawrence Raful, *What Balance in Legal Education Means to Me: A Dissenting View*, 60 J. LEGAL EDUC. 135, 135 (2010). Certainly, in that regard, corporate governance/law scholarship follows in the (former) tracks of other academic disciplines in which it is (was) often claimed that the systematic study of trust is neglected and the phenomenon of trust (including its relevance for the academic discipline in question) is poorly understood. *See*, *e.g.*, Annette Baier, *Trust and Antitrust*, 96 ETHICS 231, 232 (1986) ("Moral philosophers have always been interested in cooperation between people, and so it is surprising that they have not said more than they have about trust."); Child, *supra* note 1, at 275 (stating that in the context of the globalization of business in the modern world, "trust remains an undertheorized, under-researched, and therefore poorly understood phenomenon"); Dasgupta, *supra* note 1, at 49 ("Trust is central to all transactions and yet economists rarely discuss the notion."); Gambetta, Foreword, *supra* note 3, at x ("[I]n the social sciences the importance of trust is often acknowledged but seldom examined, and scholars tend to mention it in passing, to allude to it as a fundamental ingredient or lubricant, an unavoidable dimension of social interaction, only to move on to deal with less intractable matters."); Lewis & Weigert, *supra* note 13, at 967 ("There is a large quantity of research on trust by experimental psychologists and political scientists, which, however, appears theoretically unintegrated and incomplete."); Niklas Luhmann, *Trust: A Mechanism for the Reduction of Social Complexity*, *in* NIKLAS LUHMANN, TRUST AND POWER 4, 8 (1979) (lamenting the "regrettably sparse literature which has trust as its main theme within sociology"); Rousseau et al., *supra* note 14, at 394 ("To date, we have had no universally accepted scholarly definition of trust.").

[20]Kenneth J. Arrow, *Gifts and Exchanges*, 1 PHIL. & PUB. AFF. 343, 357 (1972); *see also* ARROW, *supra* note 1, at 26 ("It has been observed . . . that among the properties of many societies whose economic development is backward is a lack of mutual trust."); Baier, *supra* note 19, at 232 ("It seems fairly obvious that any form of cooperative activity . . . requires the cooperators to trust one another . . . ."); Dasgupta, *supra* note 1, at 49 ("Trust is central to all transactions . . . ."); Galston, *supra* note 1, at 129.

[21]Tamar Frankel, *Fiduciary Duties*, *in* 2 E-O THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127, 127 (Peter Newman ed., 1998) (emphasis added).

[22]Belcher, *supra* note 11, at 161.

[23]*See* Geoffrey P. Miller, *Norms and Interests*, 32 HOFSTRA L. REV. 637-38 (2003); Mitchell, *Being Trusted*, *supra* note 11, at 615.

[24]By referring to "protolegal variables," an admittedly open-ended and diffuse term, I try to

relationship or affiliation which we see appearing during different times in history,[25] across a wide spectrum of the law (for example, in the laws governing agents, partners, trustees, investment fund managers, securities brokers, banks, parent companies and majority shareholders, unions, attorneys, guardians, physicians, clergymen, etc.),[26] and which we label as "fiduciary."[27] The fiduciary is a genuine model citizen: She is "cooperative" and "other-regarding"[28] to a fault; always beneficent;[29] she is loyal,[30] honest,[31] and faithful[32] to her entrustor(s); she is diligent,[33] confident,[34] responsible,[35] fair,[36] empathic,[37] self-sacrificing and altruistic[38] in the pursuit of her charges;

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distill into one category all those socio-contextual, behavior-oriented and reciprocal normative implications and foundations of interpersonal cooperation which are based on expectations and counter-expectations. *See* Reich-Graefe, *supra* note 4, at 502-22 (providing a detailed discussion of "protolegal variables").

[25] *See* Frankel, *supra* note 21, at 127.

[26] *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 432-34 (1993); Frankel, *supra* note 21, at 127.

[27] *See* Frankel, *supra* note 21, at 127. The very word "fiduciary" is a derivative of "fiducia" or "fidere." *See* MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 465 (11th ed. 2004). "Fides" or "fede" translate into "trust." *See* Anthony Pagden, *The Destruction of Trust and its Economic Consequences in the Case of Eighteenth-century Naples*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 127, 129 (Diego Gambetta ed., 1988). In contrast, the modern English word "trust" is etymologically derived from Scandinavian languages; thus, for example, "trust" is the derivative of the Icelandic "traust," meaning "trust, protection, firmness, confidence" and the Swedish and Danish "tröst," meaning "comfort [and/or] consolation." *See* WALTER W. SKEAT, AN ETYMOLOGICAL DICTIONARY OF THE ENGLISH LANGUAGE 666 (Macmillan & Co., New York 1882). A variant of "trust" derived from the Scandinavian family is "trist" or "tryst," meaning "an appointment to meet," thus, "[p]roperly a pledge." *See id.*

[28] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1739; Stout, *Proper Motives*, *supra* note 18, at 23.

[29] *See* FitzGibbon, *supra* note 14, at 308 ("A fiduciary must be beneficent.").

[30] *See* Mitchell, *Trust and Team Production*, *supra* note 9, at 869; *see also* Diego Gambetta, *Can We Trust Trust?*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 213, 218 n.9 (Diego Gambetta ed., 1988) ("*Loyalty*, in this context, can perhaps be seen as the maintenance of *global* trust – in a person, a party, an institution – even in circumstances where *local* disappointments might encourage its withdrawal.").

[31] *See* Ben-Ner & Putterman, *supra* note 1, at 528-29 ("truth-telling"); Robert Cooter & Melvin A. Eisenberg, *Fairness, Character, and Efficiency in Firms,* 149 U. PA. L. REV. 1717, 1723 (2001); Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 466 (2007); Oliver Hart, *Norms and the Theory of the Firm*, 149 U. PA. L. REV. 1701, 1701-03 (2001).

[32] *See* Lyman P.Q. Johnson, *Faith and Faithfulness in Corporate Theory*, 56 CATH. U. L. REV. 1, 25-28 (2006); Michael J. Meurer, *Law, Economics, and the Theory of the Firm*, 52 BUFF. L. REV. 727, 740 (2004); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 797 (2007) [hereinafter Stout, *Mythical Benefits*].

[33] *See* Frankel, *supra* note 21, at 130.

[34] *See* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 241 (2009); O'Kelley, *supra* note 5, at 769.

[35] *See* Stout, *Proper Motives*, *supra* note 18, at 18.

[36] *See* Ben-Ner & Putterman, *supra* note 1, at 529; Hart, *supra* note 31, at 1703; Meurer, *supra* note 32, at 744 ("fair dealing"); Mitchell, *Fairness and Trust*, *supra* note 4, at 425-26; Stout,

and, as a result, she will perform *to perfection* without any need (and additionally, often without any possibility—hence, the central agency cost problem)[39] of supervision, monitoring or other forms of control by her entrustor(s).[40] The perpetual model fiduciary is, of course, a legal fiction—a mere utopian idea. All humans are not model citizens most of the time. Thus, in order to be able to discriminate efficiently—in the process of detecting, and engaging with, "fiduciaries"—among all of the other human beings with whom I must engage, by necessity, for the limited purpose of some collective cooperative activity at some point in time, I require a good compass—a good "fiduciary indicator."[41] Trust has always fit that bill.[42]

Third—and more relative to the phenomenon of trust in the realm of fiduciary relationships *within the law of business corporations*—the generally accepted wisdom in such area of the law has always posited that legally-imposed fiduciary duties of corporate directors (who, in making business decisions on behalf of the corporation, are required to act on an informed basis, in good faith, and in the honest belief that the action taken is in the best interests of the corporation)[43] are the central "enforcement

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Investor Confidence, *supra* note 1, at 424.

[37]*See* Mitchell, *Being Trusted*, *supra* note 11, at 607-08.

[38]*See* Ben-Ner & Putterman, *supra* note 1, at 529; Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1809-10 ("concern for others"); George W. Dent, Jr., *Race, Trust, Altruism, and Reciprocity*, 39 U. RICH. L. REV. 1001, 1001 (2005); Jones, *supra* note 7, at 125-26; Stout, *Proper Motives*, supra note 18, at 12.

[39]*See* Frankel, *supra* note 21, at 130 ("Like the duty of loyalty, the duty of care is triggered when the entrustors' high costs of monitoring the quality of fiduciaries' services might deter entrustors from entering the relationship.").

[40]*See id.* at 129-30 ("Fiduciary law vests in entrustors the *legal right to rely on the honesty of their fiduciaries* by imposing on fiduciaries a corresponding duty of loyalty and other specific duties to deter dishonesty. . . . Further, fiduciary law vests in entrustors the *legal right to receive quality fiduciary services, commensurate with reasonable expectations of entrustors*, by imposing on fiduciaries a corresponding duty of care in the performance of their services. . . . Fiduciary duties vary with the costs of specifying and monitoring entrustors' services, the degree of potential risk of losses from the relationship to entrustors, and the extent to which there are no alternative mechanisms to protect entrustors from such risks.").

[41]*Cf.* Stout, *Proper Motives*, *supra* note 18, at 23 (listing questions that can be asked in evaluating whether a certain individual is one "whom you want to invite to join your board").

[42]Arguably, trust lets me find people that are good fiduciaries because it helps me evaluate their respective moral compasses and also calibrate their compasses with mine. *Cf.* Mitchell, *Fairness and Trust*, *supra* note 4, at 430 ("Fiduciary relationships are, characteristically, relationships of trust and dependency in which the dependent party (the beneficiary) has ceded control over some portion of her life to the power-holding power (the fiduciary) with the expectation that the power-holding party will exercise that control for her benefit."); Stout, *Proper Motives*, *supra* note 18, at 23 ("[T]o do a good job on a board an individual needs an 'internal gyroscope'—something that will keep her steady on her course, despite outside pressures to stray.").

[43]*See, e.g.*, MODEL BUS. CORP. ACT § 8.30(a) (2011) ("Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation."); Guttman v. Huang,

agency"[44] and behavioral constraint[45] provided by our American law of corporate governance—indeed, these duties are the single most important issue in our American corporate law.[46] Now, those very fiduciary duties—as status-based,[47] delictual obligations[48] imposed on directors as a matter of law

823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest."); *see also* DEL. CODE ANN. tit. 8, §§ 145(a), 145(b), 271 (2011); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) ("In the board's exercise of corporate power to forestall a takeover bid our analysis begins with the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."); Davis v. Louisville Gas & Electric Co., 142 A. 654, 659 (Del. Ch. 1928) ("The judgment of the directors of corporations enjoys the benefit of a presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve.").

[44] *Cf.* Dasgupta, *supra* note 1, at 50.

[45] *See* Frankel, *supra* note 18, at 128 ("The ultimate effect of the law is to provide entrustors with incentives to enter into fiduciary relationships, by reducing entrustors' risks and costs of preventing abuse of entrusted power, and of ensuring quality fiduciary services."); Lawrence Lessig, *The New Chicago School*, 27 J. LEGAL STUD. 661, 662 (1998).

[46] *See* WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS xxii (2003) ("In the end, what makes [the law of business organizations] so interesting (and frustrating) to students, practitioners, and scholars alike is the vital role played in it by the open-textured concept of fiduciary duty."); Robert B. Thompson, *The Story of* Meinhard v. Salmon*: Fiduciary Duty's Punctilio*, *in* CORPORATE LAW STORIES 105, 105 (J. Mark Ramseyer ed., 2009) (stating that fiduciary duties constitute "the most important issue in the law of business associations").

[47] *See* Child, *supra* note 1, at 276 ("Family membership normally provides the strongest basis for traditional trust . . . . Many traditional foundations for trust are . . . synonymous with belonging to the same peer group or culture . . . ."). *Cf.* Larry E. Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. NEW ENG. L. REV. 531, 534 (2011) ("The earliest small firms were partnerships, which began as intimate, usually family, relationships. They were referred to as 'compagnia,' which means those sharing bread, reflecting their origins in households. Kinship ties were an important mechanism for controlling agency costs.") (footnotes omitted); *id.* at 535 ("[T]raditional partnership fiduciary duties reflect partnership's intimacy."). The utilization of status-based solutions (*i.e.*, fiduciary duties) to the fundamental principal-agent problem in corporate governance can, thus, loosely be recognized as a reversal of Henry Sumner Maine's famous finding in 1861 that the history and evolution of English law—in terms of legal anthropology—are best understood as a movement from *status* (as the controlling feature of interrelations in primitive communities) to *contract* (as a characteristic and key determinant of relationships in progressive, developed societies). *See* HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY, AND ITS RELATION TO MODERN IDEAS 163-68 (London J. Murray 1861).

[48] Fiduciary duties are traditionally seen as "delictual" obligations (*i.e.*, their breach resonates in tort, not in contract). *See* ENEA v. Superior Court, 132 Cal. App. 4th 1559, 1566-67 (2005) (describing the fiduciary duties involved in the case as "delictual" duties "imposed by law" and that "their breach sounds in tort"); *see also* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 887-88 (explaining the differences between contract and fiduciary law). *But see* Easterbrook & Fischel, *supra* note 26, at 427 ("Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings."); Alces, *supra* note 34, at 244 ("All fiduciary relationships are, at some level, contractual."); Alces, *supra* note 34, at 270-71 ("Even though all fiduciary relationships are contractual, not all contractual relationships are fiduciary.").

(or, more precisely, as a matter *in equity* or *in chancery*)[49]—"represent essential trust relationships."[50] These trust relationships were developed and recognized historically within corporate law (and within the law of business organizations more generally) through a confluence and gradual adaptation of the older and more developed laws of partnership and agency[51] and the law of trusts.[52] As Frederic Maitland, the English jurist and legal historian, already observed more than a century ago:

> [T]he connection between Trust and Corporation is very ancient. It is at least four centuries old.[53]

Suffice it to say here that, whereas law and economics and the contractarian (or nexus-of-contracts) model of the corporate firm,[54] to date, have extensively demonstrated the thrust of *contract theory* for purposes of

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[49]*See* Frankel, *supra* note 21, at 127; Lyman Johnson, *Enduring Equity in the Close Corporation*, 33 W. NEW ENG. L. REV. 313, 316 (2011); L. S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 69.

[50]Siebecker, *supra* note 11, at 118-19. *See also* Heminway, *supra* note 11, at 187 ("Trust is at the heart of the fiduciary relationships that characterize corporate governance . . . ."); Mitchell, *Fairness and Trust*, *supra* note 4, at 430, 475 (describing the role of trust in the corporate context and stating that "[t]he bedrock of corporate relationships is, I believe, trust.").

[51]*See, e.g.*, Meinhard v. Salmon, 164 N.E. 545, 546 (1928) (Cardozo, C.J.) ("A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."); *see also* Frankel, *supra* note 21, at 127; Rock & Wachter, *Dangerous Liasions*, *supra* note 15, at 651, 655-56.

[52]Easterbrook & Fischel, *supra* note 26, at 425; Rock & Wachter, *Dangerous Liasions*, *supra* note 15, at 656-57; Wedderburn, *supra* note 9, at 203; *see also* Epstein, *supra* note 11, at 5 (mentioning "one of the central issues of corporate law: the relationship of contract and trust theory to the governance and operation of corporations").

[53]Frederic W. Maitland, *Trust and Corporation*, *in* MAITLAND: SELECTED ESSAYS 141, 214 (H. Hazeltine, G. Lapsley & P. Winfield eds., 1936); *see also* Wedderburn, *supra* note 9, at 203.

[54]*See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 92-93 (1991); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777-78 (1972); Easterbrook & Fischel, *supra* note 26, at 431-32; Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 288-89 (1980); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301-02 (1983); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976). For a discussion and critique of the contractarian (or nexus-of-contracts) model of the firm, *see* William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400-01 (1993); Eisenberg, *supra* note 6, at 822-23; Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 300-01 (1993); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 784-91 (2006); Reich-Graefe, *supra* note 6, at 380-87.

analyzing and explaining the governance and operation of the corporate endeavor,[55] a similarly abundant theoretical inquiry and analysis with regard to the value of *trust theory*, for purposes of understanding the behavioral constraints imposed on corporate managers, has yet to materialize in robust terms.[56] The question that can be asked here is: Why have we not (yet) developed a broader, non-coercionist[57] *fiduciarian* (or *nexus-of-trust*)[58] *model* of the firm[59] in which both economic *efficiency* and economic *equity*[60] inform (and predict)[61] the structures and substance of economic affiliation and cooperation?[62]

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[55]*See, e.g.*, Ind. Harbor Belt R.R. Co. v. Am. Cyanamid Co., 916 F.2d 1174, 1182 (7th Cir. 1990) ("A corporation is not a living person but a set of contracts the terms of which determine who will bear the brunt of liability."); EASTERBROOK & FISCHEL, *supra* note 54, at 17 ("All the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties."); Allen, *supra* note 54, at 1400 ("[A] corporation may be said most fundamentally to be a contractual governance structure."); Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 770 (1989) ("The most important conceptual step toward applying the contract clause to the corporation is simply recognizing that corporate governance arrangements are, indeed, contracts."); Hart, *supra* note 54, at 306 ("[T]he firm will rely on implicit contracts to uphold many of its business dealings.").

[56]*Cf.* Bukspan, *supra* note 11, at 252-58 (explaining that some issues in corporate and securities law "seem appropriate for further research based on the trust theory of contract and corporate law").

[57]By which I mean a model that is neither "contractarian" nor "anticontractarian" but rather a model in which *legal* fiduciary obligations may turn out to be mostly irrelevant (as would be the long debate about whether and to what extent it should be permissible to opt out of them) and in which the principal enforcement agency and behavioral constraint on director/manager decision-making would derive from *moral*/*social* obligations and responsibilities and their related enforcement mechanisms—among them, it would seem, principally, trust. *See also* Galston, *supra* note 1, at 130 ("High-trust societies can function with fewer regulations and coercive enforcement mechanisms."); *cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1780-82 ("The conventional nexus of contracts approach to corporate law attempts to explain how firms work, and the role of law in making them work, solely in terms of market incentives and legal obligations . . . . [T]here is reason to believe[, however,] that trust may play an important role in the success of many business firms.").

[58]*Cf.* Eisenberg, *supra* note 6, at 822-23 (preferring the term "nexus of reciprocal arrangements" over the contractarian terminology "nexus of contracts").

[59]The closest model of the firm resembling such a fiduciarian (or nexus-of-trust) model of the firm is the Blair-Stout team production model of hegemonic corporate governance, which is based on earlier team-production models developed by economists, in particular, Alchian & Demsetz, *supra* note 54, at 779.

[60]*Cf.* ALLEN & KRAAKMAN, *supra* note 46, at xxii (referring to the "admixture of morality and efficiency" undergirding fiduciary obligation law); Peter Smith Ring & Andrew H. Van de Ven, *Developmental Processes of Cooperative Interorganizational Relationships*, 19 ACAD. MGMT. REV. 90, 101 (1994) (stating that cooperative interorganizational relationships emerge and grow when "basic norms of equity and efficiency" are met).

[61]Predictive ability and accuracy is, of course, the main criterion by which positive (descriptive) economic models are evaluated. *See* Milton Friedman, *The Methodology of Positive Economics*, *in* THE PHILOSOPHY OF ECONOMICS: AN ANTHOLOGY 145, 152 (Daniel M. Hausman

Fourth—with regard to the *substance* and *ultimate purpose* or *societal benefit* of fiduciary relationships of corporate managers *within the law of business corporations*—the perennially unresolved and irresolvable[63] shareholder-stakeholder primacy discussion in corporate law (tracing all the way back to the famous primacy debate between Adolf Berle and Merrick Dodd in the wake of the Great Depression)[64] remains explicitly clothed in paradigms and structures of trust relationships existing between corporate directors/managers on the one hand, and both the firm and all of its participants, collectively, and groups of firm participants, individually (for example, shareholders as a group), on the other hand.[65] Berle and Dodd, of

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ed., 3d ed. 2008) ("But economic theory must be more than a structure of tautologies if it is able to predict and not merely describe the consequences of action; if it is to be something different from disguised mathematics."); Fred S. McChesney, *Positive Economics and All That—A Review of* The Economic Structure of Corporate Law *by Frank H. Easterbook & Daniel R. Fischel*, 61 GEO. WASH. L. REV. 272, 278 (1992) ("Positive economics submits itself to the rigor of scientific method. Submission means that the model's value is to be judged not only by its internal consistency and adherence to accepted principles, but also by its ability to predict the occurrence of events in the real world. It must be possible to derive from the model behavioral implications, at least some of which must be empirically falsifiable and therefore testable."); Fred S. McChesney, *The "*Trans Union*" Case:* Smith v. Van Gorkom, *in* THE ICONIC CASES IN CORPORATE LAW 231, 253 (Jonathan R. Macey ed., 2008); O'Kelley, *supra* note 5, at 757. *See also* BAINBRIDGE, *supra* note 7, at 2-3 ("The predictive power of any model of the corporation must be measured by the model's ability to predict the separation of ownership and control, the formal institutional governance structures following from their separation, and the legal rules responsive to their separation."); Stephen M. Bainbridge, *Competing Concepts of the Corporation (a.k.a. Criteria? Just Say No)*, 2 BERKELEY BUS. L.J. 77, 81 (2005) [hereinafter Bainbridge, *Competing Concepts*] (stating that Professor Bainbridge's model, as opposed to Professor William A. Klein's model, "does a better job of explaining and predicting corporate law"); Mitchell, *Being Trusted*, *supra* note 11, at 596 ("[T]he neo-classical model that dominated law, and economics, for decades, has come to be seen as too limited to explain obvious and observable social phenomena.").

[62]*Cf.* Belcher, *supra* note 11, at 154 (referring to a "trust-based framing of the analysis" of fiduciary and other duties of directors).

[63]I have argued elsewhere (focusing on the shareholder primacy model) that such debate is logically unresolvable within the parameters of corporate (governance) law. *See* Reich-Graefe, *supra* note 6, at 379-80.

[64]A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (presenting Berle's thesis "that all powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears"); A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1365-69 (1932) (providing a response to Dodd's challenge of Berle's theory); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147-48, 1152 (1932) (challenging Berle's theory); E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194, 205-07 (1935) (providing a response to Berle's response).

[65]*Cf.* Berle, *supra* note 64, at 1049 ("[T]he *use* of [corporate] power is subject to equitable limitation when the power has been exercised to the detriment of [shareholder] interest . . . . [I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a *cestui que trust* to the trustee's exercise of wide powers granted to him in

course, arrived at different answers but they asked the same questions: For whose benefit should corporate directors/managers be acting *as trustees*; and to whom should they owe resultant fiduciary duties?[66] What is the character and utility of such fiduciary duties?[67] Are fiduciary duties only majoritarian default (*i.e.*, essentially, standard contract) terms which fill in remaining gaps left after the (implied) contracting by firm participants; or are we examining a relationship and phenomenon of trust which is *sui generis* and independent of the promissory undertakings that have brought the participants of the firm together to join their economic resources?[68] These questions have formed the core of the debate in corporate legal theory for the last eighty years.[69] However, a discussion and analysis of trust as an integral (if not, controlling) part of the equation *and* solution has been prominently absent in such discussion until fairly recently (and, arguably, even now, it only occurs in early fits and starts).[70]

Fifth—even though modern corporate law, as currently written, has shied away from describing corporate directors explicitly as "*trustees*,"[71]

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the instrument making him a fiduciary."); Dodd, *supra* note 64, at 1146-48 ("The directors and other agents are fiduciaries carrying on the business in the sole interest of the stockholders. [I]t is undoubtedly the traditional view that a corporation is an association of stockholders formed for their private gain and to be managed by its board of directors solely with that end in view. [P]ublic opinion, which ultimately makes law, [however] has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function . . . ."). For an overview of the Berle-Dodd debate, *see generally* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264-66 (1992); Bratton & Wachter, *Corporatist Origins*, *supra* note 7, at 122-35; Fisch, *supra* note 6, at 646-48; Carlos L. Israels, *Are Corporate Powers Still Held in Trust?*, 64 COLUM. L. REV. 1446, 1446 (1964); A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 36-39 (1991); Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964). In an interesting twist to today's prevailing views on shareholder primacy, Adolf Berle explicitly conceded defeat of his shareholder primacy model to Dodd's stakeholder-oriented model once *A. P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953) was decided. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 168-69 (1954); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 561 n.70 (2003) [hereinafter Bainbridge, *Means and Ends*].

[66] *See supra* note 65 (stating Berle and Dodd's respective positions regarding the corporation, and how fiduciary duties are present in both positions).

[67] *Id.*

[68] *See supra* note 57 (discussing trust and "contractarian" and "anticontractarian" theories).

[69] *See supra* note 65 (providing background of the Berle-Dodd debate).

[70] *See supra* notes 42, 57-62 and accompanying text.

[71] For example, neither Section 8.30(a) of the Model Business Corporation Act nor Sections 145(a), 145(b), nor 271 of the Delaware General Corporation Law make any reference to corporate directors or officers as "trustees." *See* DEL. CODE ANN. tit. 8, §§ 145(a), 145(b), 271 (2011); MODEL BUS. CORP. ACT § 8.30(a) (2011). *But cf.* Charitable Corp. v. Sutton, 2 Atk. 400, 405 (1742) (describing the "committee-men" of a corporation as "most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the

contemporary corporate theory has more or less explicitly moved back to the (original) notion that trust relationships exist between the corporation's directors/managers and its other participants and factors of production, and that those trust relationships secure and control the fidelity and diligence of the former with regard to the firm investment interests of the latter.[72] To this effect, the Blair/Stout team production model[73] explicitly recognizes corporate directors as "trustees"[74] (or "fiduciaries"[75] or "trusted mediators"[76]). Furthermore, the Bainbridge director primacy model[77] recognizes board

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corporation"); Sealy, *supra* note 49, at 70 (quoting *Charitable Corp.*).

[72]*See, e.g.*, Blair & Stout, *Director Accountability*, *supra* note 11, at 408 (discussing the need "to look beyond the economic literature and consider the extensive work that has been done in other branches of the social sciences on the phenomenon of intrinsic trustworthiness"); Mitchell, *Trust and Team Production*, *supra* note 9, at 909-12 (discussing "trust in team production").

[73]*See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1735; Blair & Stout, *Director Accountability*, *supra* note 11, at 404; Blair & Stout, *Introduction*, *supra* note 8, at 743, 743-45; Margaret M. Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, 7 EUR. BUS. ORG. L. REV. 473, 473-74 (2006); Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in* Corporate Law, 31 J. CORP. L. 719, 719-21 (2006) [hereinafter Blair & Stout, *Explaining Anomalies*]; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 249 (1999) [hereinafter Blair & Stout, *Team Production Theory*]. *See also* Stephanie Ben-Ishai, *A Team Production Theory of Canadian Corporate Law*, 44 ALBERTA L. REV. 299 (2006); 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); Allen Kaufman & Ernie Englander, *A team production model of corporate governance*, 19 ACAD. MGMT. EXECUTIVE 9, 9 (2005); Lynn M. LoPucki, *A Team Production Theory of Bankruptcy Reorganization*, 57 VAND. L. REV. 741 (2004); Mitchell, *Trust and Team Production*, *supra* note 9, at 870; D. Gordon Smith, *Team Production in Venture Capital Investing*, 24 J. CORP. L. 949, 950-51 (1999). For a critical analysis and discussion of the team production model, *see* Dent, *supra* note 6, at 1229-33; Alan J. Meese, Essay, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1645-46 (2002); Reich-Graefe, *supra* note 6, at 387-93.

[74]Blair & Stout, *Team Production Theory*, *supra* note 73, at 291; Blair & Stout, *Introduction*, *supra* note 8, at 746; *see also* Belcher, *supra* note 11, at 161 (stating that "[d]irectors are . . . in a position of trust"); DeMott, *supra* note 48, at 880 (stating that "directors occupy a trustee-*like* position").

[75]Blair & Stout, *Director Accountability*, *supra* note 11, at 425; Blair & Stout, *Team Production Theory*, *supra* note 73, at 291.

[76]Blair & Stout, *Director Accountability*, *supra* note 11, at 408; *see also* Benjamin E. Hermalin & Michael S. Weisbach, Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature, 9 FED. RES. BANK N.Y. ECON. POL'Y REV. 7, 9-10 (2003) ("Our point of departure therefore is that a board of directors is the equilibrium solution (albeit possibly second best) to some agency problems confronting the firm.").

[77]*See* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 8, at 192-93; BAINBRIDGE, *supra* note 7, at 10-11; Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 6-7 (2002) [hereinafter Bainbridge, *Nexus of Contracts*]; Bainbridge, *Abstention Doctrine*, *supra* note 8, at 85-86; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 603 (2006); Bainbridge, *Competing Concepts*, *supra* note 59, at 88; Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1747 (2006); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 794-795 (2002); Bainbridge, *Means*

directors in the role of "Platonic guardians"[78]—a form of trustees similar to the philosopher kings in Plato's *Republic* who always seemed to see it fit to rule "for the public good, not as though they were performing some heroic action, but simply as a matter of *duty*."[79] In this regard, however, Annette Baier has reminded us that Plato's *Republic* was not a well-developed (political) model from its very start:

> Plato in the *Republic* presumably expects the majority of citizens to trust the philosopher kings to rule wisely and expects that elite to trust their underlings not to poison their wine, nor set fire to their libraries, but neither proper trust nor proper trustworthiness are among the virtues he dwells on as necessary in the cooperating parties in his good society.[80]

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and Ends, *supra* note 65, at 550; Bainbridge, *Director v. Shareholder*, *supra* note 6, at 46; Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency*, 1 J. BUS. & TECH. L. 335 (2007); Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769 (2006); Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002). For critical analysis and discussion of the director primacy model, *see* Dent, *supra* note 6, at 1216-20; Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of* The New Corporate Governance in Theory and Practice, 34 DEL. J. CORP. L. 139, 144-61 (2009); Reich-Graefe, *supra* note 6, at 393-95.

[78] Bainbridge, *Nexus of Contracts*, *supra* note 77, at 8 & n.28; Bainbridge, *Director v. Shareholder*, *supra* note 6, at 51; Bainbridge, *Means and Ends*, *supra* note 65, at 550-51 & n.21; *see also* In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 698 (Del. Ch. 2005) (referring to corporate decision-makers as "faithful servants"); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 L. & CONTEMP. PROBS. 83, 84 (1985) (stating that the "monitoring model" of director control in corporate governance "appears to be premised upon the unsubstantiated belief that directors . . . will be faithful guardians of the corporation's interest . . . .").

[79] Bainbridge, *Nexus of Contracts*, *supra* note 77, at 8 n.28 (emphasis added) (quoting PLATO, THE REPUBLIC 289-90 (Benjamin Jowett trans., Random House 1991)). This guardianship concept seems to correlate with "[n]eoclassical [economic] theory [which] views the firm as a set of feasible production plans . . . over [which] a selfless and compliant manager [presides]." Hart, *supra* note 54, at 299. Similarly, "Adolf Berle viewed the emergence of independent corporate managers as a [beneficial] development . . . [namely], a mechanism for producing truly public-regarding servants." Romano, *supra* note 7, at 923-24; *see also* ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY 2-3, 8 (1959) (describing "big businessmen" as "a variety of non-Statist civil servant[s]"). Similarly, there is "Frank H. Knight's mythic entrepreneur," a "free market superhero" (Gilson & Kraakman, *supra* note 9, at 605), who is the ultimately *responsible* manager owning and controlling her business and doing what is right out of sheer self-motivation and self-respect, thus, without any legal mandate being required or operational. *See id; see also* KNIGHT, *supra* note 7, at 271 ("The essence of enterprise is the specialization of the function of *responsible direction* of economic life . . . . Under the enterprise system, a special social class the business men, direct economic activity . . . .").

[80] Baier, *supra* note 19, at 232-33.

Fortunately, Margaret Blair and Lynn Stout have begun to examine trust and trustworthiness[81]— however, it does not appear as an integral and central tenet of their ground-breaking team production model.[82]

Sixth—and staying with *contemporary corporate theory*[83] and also my personal iteration of the same—I have argued in two earlier, related articles[84] that the law of fiduciary duties of corporate directors, though considered the "backbone of modern corporate law,"[85] is—for the most part—entirely vacuous as a regulatory tool in order to ensure accountability of corporate decision-makers.[86] In other words, any value of fiduciary duties for purposes of controlling the absolute decision-making discretion and authority given to corporate boards by clear, unison, and specific (state) statutory commands,[87] is—from a legal analysis and perspective—strictly fictitious.[88] Lamentations with regard to the non-utility of fiduciary duties for purposes of establishing an efficient, real-world behavioral constraint on corporate directors have

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[81]Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1753-59.

[82]They momentarily come close to this integral discussion of trust and team production in Blair & Stout, *Director Accountability*, *supra* note 11, at 441-43.

[83]*See supra* note 72 and accompanying text.

[84]Reich-Graefe, *supra* note 6, at 341; Reich-Graefe, *supra* note 4, at 471-74.

[85]Siebecker, *supra* note 11, at 119; *see also* ALLEN & KRAAKMAN, *supra* note 46, at xxii; Thompson, *supra* note 46, at 105.

[86]*See* sources cited *supra* note 84.

[87]*See, e.g.*, DEL. CODE ANN. tit. 8 § 141(a) (2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); MODEL BUS. CORP. ACT § 8.01(b) (2010) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors . . . ."); *see also* ROBERT CHARLES CLARK, CORPORATE LAW 141 (1986) (discussing the board's power and duties); RICHARD W. HAMILTON & RICHARD A. BOOTH, BLACK LETTER OUTLINES: CORPORATIONS 505 (5th ed. 2006) ("The role of directors is specified by statute. The board of directors is entrusted with the power of management of the business and affairs of the corporation."); Blair & Stout, *Introduction*, *supra* note 8, at 746 ("While the board is nominally elected by the shareholders . . . as a matter of law it remains insulated from the direct command and control of . . . other corporate constituents."). "Under statutes in all states, business corporations are managed by or under the direction of a board of directors elected by their shareholders." Dent, *supra* note 6, at 1216; *see also* Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89, 92 (2004) ("American corporation statutes provide, with minor variations in language, that a corporation shall be managed by or under the direction of its board of directors."); Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183, 188 (2004) ("[C]orporations are managed by or under the control of a centralized board of directors. Delegating power to a relatively small group of people enables more efficient decision-making than dispersing power among many owners.").

[88]*Cf.* ARROW, *supra* note 1, at 66 ("Some fifty years ago, it became widely recognized that the nominal responsibility of corporations to their stockholders was in good part fictitious.").

been legion for a long time.[89] However, we always seem to shy away from saying clearly, loudly, and perhaps *brutally* that, in the vast majority of cases, corporate (governance) law—as a mechanism of controlling the behavior of corporate managers and, thus, overall corporate behavior effectively—has *absolutely nothing* to do with corporate governance.[90]

In this vein, I have previously developed an *absolute director primacy model* of the firm and have argued that a well-advised and disinterested corporate board in a modern Berle-Means corporation is uncontrollable in absolute terms.[91] If the board's decision is not inflicted by any non-insulated or non-sanitized self-interest of the acting directors,[92] virtually *everything*—every motive and every end underlying untethered directorial decision-

[89] *See, e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 226 ("In practice, however, cases in which the business judgment rule does not shield operational decisions from judicial review are so rare as to amount to little more than aberrations."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1791 ("The net result is that, as a practical matter, a negligent director is more likely to be hit by lightning after leaving her board meeting than she is to pay damages."); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) ("Corporate managers have never had an enforceable legal duty to maximize corporate profits."); Jones, *supra* note 7, at 117 ("Independent directors face an infinitesimal risk of paying personally for damages to the corporation caused by their breach of fiduciary duty. They face no real risk of liability for their acts or omissions as directors."); Mitchell, *Trust. Contract. Process.*, *supra* note 8, at 190 (stating that "directors have largely unlimited power over the corporation and its affairs"); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1623 (2001) [hereinafter Rock & Wachter, *Islands*] (describing the business judgment rule as "assuring that enforcement [of the duty of care] is almost entirely nonlegal"); Siebecker, *supra* note 11, at 119 (stating that "[fiduciary duties] remain frustratingly amorphous as currently applied by courts"); Stout, *Proper Motives*, *supra* note 18, at 6 ("The business judgment rule . . . allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability."); *id.* at at 7 ("[I]t is only a slight exaggeration to suggest that a corporate director is statistically more likely to be attacked by killer bees than she is to have to ever pay damages for breach of the duty of care."); *see also* Alces, *supra* note 34, at 242 ("It is dangerous and costly to assume that fiduciary duties function well in the corporate context. The assumption may give shareholders a false sense of security or a belief that they are able to discipline management effectively when in fact, because of the very limited nature of corporate governance duties, they are not.").

[90] What it does do is provide the structure and mechanics of the basic internal decision-making and governance hierarchy of the corporation. *See* Ronald J. Gilson, *Separation and the Function of Corporation Law*, 2 BERKELEY BUS. L.J. 141, 147 (2005) ("The point is that markets encourage a management and governance structure that fits the corporation's business. Corporate law has nothing to add to the process."); *see also* Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459, 459 (2001) ("This paper casts doubt on the extent to which legal regulation matters in the corporate governance context.").

[91] *See infra* Part II.A.

[92] Which board decision corporate law would then invalidate for breach of the fiduciary duty of loyalty if unfair to the corporation. *See, e.g.*, Blair & Stout, *Introduction*, *supra* note 8, at 746 (stating that the board is "precluded by law from using [its] control for [its] own personal benefit").

making power—can become a permissible purpose in order to justify the board's decision as long as judicial review, within the parameters of the business judgment rule presumption,[93] can devise a minimum proper rationale for the decision being made in good faith and with a reasonable belief in the best interests of the corporation.[94]

If we assume, for the sake of discussion, that this argument is correct, every rational firm participant can now be expected to ask the same question: "*Why invest?*"[95] Why completely expose concrete financial interests, resources, and chances of future wealth and financial well-being to corporate decision-makers, who are uncontrollable and can destroy those interests, resources, and chances by incompetence, by negligence,[96] by blatant opportunism, by shirking their managerial duties, or even by ill will[97] *and* get

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[93]The business judgment rule—as the central instrument of judicial review of alleged violations of director fiduciary duties (care, loyalty, obligation of good faith) and, arguably, corporate law's principal response to so-called "Knightian uncertainty," *see* KNIGHT, *supra* note 7, at 231—holds that "[t]he judgment of the directors of corporations enjoys the benefit of a presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve." Davis v. Louisville Gas & Electric Co., 142 A. 654, 659 (Del. Ch. 1928); *see also* BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 109-10 ("Courts often refer to the business judgment rule as 'a presumption' that the directors or officers of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."); JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS 483-84 (2d ed. 2003) ("Taken to its most cynical light, the business judgment rule means that management's position is vindicated."); STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 11-15 (6th ed. 2009) (describing the business judgment rule); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1790 ("[W]hether or not the business judgment rule applies will usually turn on whether a board's act was 'informed.'").

[94]*See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose."); Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) (explaining the familiar Delaware rule); BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 114 (discussing the "rationality" behind the rule).

[95]*Cf.* Cook et al., *supra* note 2, at 122 ("[M]onitoring and sanctioning are usually too costly, even in specific organizational settings. Under these conditions, few rational people would engage in exchange . . . .").

[96]Today, in Delaware—as a direct result of the aftermath of Smith v. Van Gorkom, 488 A.2d 858, 871-74, 893 (Del. 1985)—most claims for director incompetence or negligence encounter an absolute bar and are, by law, judicially nonreviewable because the corporation in question has adopted a so-called "section 102(b)(7) provision" in its certificate of corporation. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2011); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1790-91.

[97]Again, in Delaware, good faith violations of corporate directors are—for all intents and purposes—(virtually) unreviewable. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009) (stating that "'[i]n the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.'") (alteration in original) (quoting *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 654-55 (Del.Ch. 2008)); *Lyondell*, 970 A.2d at 243-44 ("Only if [directors] knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty."); *In re* Walt Disney

away with it without personal recourse or incurring liability to firm investors?[98] In other words, if profit-maximizing is not enforced by corporate law,[99] why does it nonetheless happen as a matter of almost overwhelming routine in today's corporate reality?[100] Or formulated differently one more time: The question is not "*why* do shareholders in public companies have so little power?",[101] but why do shareholders in public companies who have so little power *still invest?*[102] Why do investors who know that they have almost no power over their investment ex post (other than complete investment exit, where possible, with a predictable loss of value) still confidently decide to invest without any ex ante bargained-for accountability of corporate managers in place?[103] The developing answers to

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Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006) (defining a fiduciary's bad faith to include "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.") (quoting *In re* Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755 (Del. Ch. 2005)); Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (limiting further—at least, in the board oversight context—imposition of liability for fiduciary bad faith by "requir[ing] a showing [by the plaintiff using particularized facts] that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.") (footnote omitted).

[98]*See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1788 ("But why would any beneficiary ever want to make herself categorically vulnerable to someone who had no external *or* internal incentive to protect her interests?").

[99]*See supra* note 89, and accompanying text.

[100]For example, the average daily trading volume on the New York Stock Exchange for NYSE-listed companies in 2012 totaled 4,072,202 trading transactions *per diem* (based on 250 trading days), comprising an average of 1,147,182,027 shares traded for a total average consideration of $35,093,813,628. Dataset available at Facts & Figures, NYSE TECH., http://www.nyxdata.com/Data-Products/Facts-and-Figures (last visited April 15, 2013). These figures can be calculated by visiting this website and clicking "Market Activity" on the left side of the page. Afterward, click "Daily NYSE Group Volume in NYSE Listed," download the historical data of daily averages in Excel spreadsheet format, and elminiate 2010, 2011 and 2013 trading days. The resulting table will show the 2012 data. Running the Excel 'Count' function (for the "Trade Date" column) and the Excel 'Average' function (for the columns "NYSE Group Shares," "NYSE Group Trades," and "NYSE Group Dollar Volume," respectively) will yield the daily average numbers as set forth above. For a discussion of the internal reasons for investing, *see also* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1737 ("[I]ndividuals who participate in corporations often expose themselves to great risk of loss from other participants' failures and misbehavior. Yet investments are made, companies are built, and value is created from complex joint production.") (footnote omitted).

[101]Stout, *Mythical Benefits*, *supra* note 32, at 792.

[102]*See* Mitchell, *Fairness and Trust*, *supra* note 4, at 431 ("[W]hy would anybody invest money in a corporation, an entity over which she has no control?"); *see also* Duggin & Goldman, *supra* note 11, at 256-57 ("Without some level of trust in corporations and those who manage their affairs, hiding money under the mattress would be more attractive than investing in stocks and bonds.").

[103]*See* Stout, *Mythical Benefits*, *supra* note 32, at 801 (pointing out "an often overlooked

these questions in the field of (corporate) legal theory bring us to my last point.

Seventh—with regard to the phenomenon of *trust in the realm of corporate governance* in the face of absent legal enforcement mechanisms to effectively ensure diligence and faithfulness of corporate directors[104]—if the purported behavioral constraint of corporate governance law (namely, fiduciary obligations of care and good faith) is vacuous and, as a matter of law, meaningless, we need to look (and should have looked long ago) carefully and systematically at particular social norms—one after the other—in order to determine their respective value for purposes of explaining why corporate directors seem to "do the right thing"[105] most of the time and at sufficient minimum levels of "rightness," thereby allowing firm participants to make, on average, billion dollar investments in large, publicly-held corporations and confidently see those investments work out successfully.[106] Social norms are powerful behavioral controllers within an overall hybrid and complex system of social control[107] which relies on the interplay of legal, market and social norm mechanisms for purposes of establishing efficient

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fact of business life: investors are not forced to purchase shares in public corporations at gunpoint"); *id.* at 803 ("Is it possible that shareholders, like Ulysses, sometimes see advantage in 'tying their own hands' and ceding control over the corporation to directors largely insulated from their own influence?") (quoting Lynn A. Stout, *The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 670 (2003)); *see also* Hermalin & Weisbach, *supra* note 76, at 9 ("Yet one does not have to hold a Chicago Ph.D. to ask, if boards are so bad, why hasn't the market caused them to improve, or even replaced the corporate form with less problematic forms of organization?"); Simon Kuper, *The real special ones: In Britain, football managers are modern celebrities but most appear not to add value to their teams*, FINANCIAL TIMES, Jan. 28, 2012, at 20 ("Generally speaking, the key assets in football aren't managers but players. The market in footballers, unlike the market in managers, is frighteningly efficient."); *supra* notes 95-102 and accompanying text.

[104]*See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1780 ("Legal sanctions and market forces often cannot bind corporate participants tightly enough to restrain all opportunistic behavior . . . ."); Elhauge, *supra* note 89, at 740 ("[O]ptimal regulation of behavior has always required supplementing necessarily imperfect legal sanctions with social sanctions and internalized moral norms."); Lessig, *supra* note 45, at 662 ("Behavior is regulated by four types of constraint. Law is just one of those constraints.") (footnote omitted).

[105]Blair & Stout, *Director Accountability*, *supra* note 11, at 439; Grossman, *supra* note 31, at 465-66; Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law: Introduction*, 149 U. PA. L. REV. 1607, 1608 (2001) [hereinafter Rock & Wachter, *Introduction*]; Stout, *Proper Motives*, *supra* note 18, at 8-9, 23; Tung, *supra* note 11, at 1175; *see also* Meurer, *supra* note 32, at 740 ("If managers were all faithful agents intent on maximizing firm profit, then adjustment in response to unforeseen contingencies should be less costly inside the firm, but this begs the question of how a firm gets managers to be pure profit maximizers.").

[106]*See supra* note 100 and accompanying text; *cf.* Belcher, *supra* note 11, at 168 (suggesting that it "must . . . be important to have laws and governance provisions in which the consequences for trust and the trust requirements are properly thought through").

[107]ELLICKSON, *supra* note 7, at 131-32 ("[D]ifferent controllers can combine their efforts in countless ways to produce hybrid systems of social control.").

constraints on the future (in-)actions of individual participants in cooperative endeavors.[108] Such a hybrid system, therefore, also casts a regulatory net over director decision-making behavior and, thus, allows for behavioral constraints on corporate directors for purposes of achieving sufficient levels of board accountability in corporate governance.[109] This Article starts the long-neglected analysis of the intersection of norms and director primacy with one of the central social norms and behavioral controllers in corporate governance and economic cooperation in this regard: trust.[110]

II. TRUST AND CORPORATE GOVERNANCE

The road to the junction of trust and corporate governance (at least, as travelled by me) begins with the latter—the law of corporate governance—and, in particular, "*absolute director primacy*," a (partially incomplete) model of corporate governance which I have previously developed in two earlier articles.[111] The road then winds through the areas of social norms and (corporate) law, and further follows along the outlines of all related avenues of legal and non-legal academic scholarship—scholarship which informs, nurtures, and maps out the intersections between trust and corporate governance. The discussion in this Part II is intended only to provide a brief overview of the ambient environment in which the phenomenon of trust structurally and functionally arises as a controlling feature within the modern theory of corporate governance. Only after such discussion does it seem meaningful to venture into an analysis of the phenomenon of trust itself.

A. *Absolute Director Primacy*

My *absolute director primacy model* from earlier works has led me to a fundamental dilemma.[112] After an in-depth survey of current microtheoretical models of the firm,[113] I have come to the conclusion that the

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[108] Lessig, *supra* note 45, at 662-64.

[109] *Cf.* ELLICKSON, *supra* note 7, at 131-32; Lessig, *supra* note 45, at 663.

[110] *Cf.* Heminway, *supra* note 11, at 194 ("If there is a locus of trust in the corporation, it is the board."); Siebecker, *supra* note 11, at 159 ("[T]he well established hierarchical structure of the corporate form makes the officers and directors of the corporation the obvious locus of our trust."). For other social norms—for example, fairness, honesty, faithfulness or empathy—*see* references in Reich-Graefe, *supra* note 4, at 506-08.

[111] *See* Reich-Graefe, *supra* note 6, at 341, 395-404; Reich-Graefe, *supra* note 4, at 471, 523.

[112] *See supra* note 111.

[113] The four main models in today's academic discussion can be labeled as "shareholder primacy," "contractarian," "team production," and "director primacy." *See* Bainbridge, *Director v.*

board of directors of a typical Berle-Means corporation can be characterized as the private-sector equivalent of a modern *Leviathan*.[114] The board itself, not shareholders on aggregate or the corporation as a whole, is the sole corporate sovereign—both *de facto* and *de jure*. The board's decision-making is by fiat,[115] and its decision-making authority to run the corporation's business and affairs as it sees fit is absolute,[116] original,[117] infinite[118] and, thus, *sui generis*.[119] I have argued that the corporate entity is inescapably and

Shareholder, *supra* note 6, at 46 (discussing shareholder-primacy and director-primacy models); Reich-Graefe, *supra* note 6, at 361-404 (discussing all four models as well as my *absolute director primacy model*); Verret, *supra* note 6, at 315-26 (discussing all four models as well as "agency theory" and "progressive corporate law theory"). *See generally* Coates, *supra* note 6 (discussing team-production models); Dent, *supra* note 6 (discussing team-production and director-primacy models); Fisch, *supra* note 6 (discussing shareholder-primacy models); Lee, *supra* note 6 (discussing shareholder primacy and team production models).

[114]The term means "a sea monster often symbolizing evil in the Old Testament and in Christian literature." *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 1301 (Philip Babcock Gove ed., 3d ed. 1981). The term "leviathan state" means "an all-powerful state . . . held to be characterized by a vast bureaucracy and machinery of coercion and exercising totalitarian control over its citizens." *Id.* "[T]he use of the word *Leviathan* to designate the state [was introduced] in the book *Leviathan* (1651) by Thomas Hobbes . . . ." *Id.*

[115]Such authoritative decisional determination by the board is, in the genuine meaning of the term "fiat", both dictatorial and, *ipse dixit*, valid. *See* BLACK'S LAW DICTIONARY 700, 905 (9th ed. 2009). It is non-reviewable and, *ipso facto*, irrebuttably assumed to be right (which, of course, is exactly the effect of the courts' applications of the business judgment rule). *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power grant to Delaware directors.").

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

[117]*See* Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918); *cf.* Burrill v. Nathant Bank, 43 Mass. (2 Met.) 163, 166-67 (1840); CLARK, *supra* note 87, at 22 ("The model behind corporate law's treatment of authority is one of a unilaterally controlled flow of authority from a single wellspring of power rather than a bubbling up and flowing together of many individual sources of personal power. The state has power; it chooses to delegate it to the board of directors of a corporation.").

[118]*See* Mitchell, *Trust. Contract. Process.*, *supra* note 8, at 190 ("The power and control that are present in all fiduciary relationships is exaggerated in the corporation where the indeterminate length of the enterprise and the practically infinite array of investment opportunities for the corporation make any possibility of specified limitations on directors' power or ongoing control by the stockholders unrealistic.").

[119]Loizos Heracleous & Luh Luh Lan, *Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective*, 49 J. MGMT. STUD. 223, 231 (2012). *Sui generis* (defined as "[o]f its own kind or class; unique or peculiar," in BLACK'S LAW DICTIONARY 1572 (9th ed. 2009)) decision-making authority of corporate directors means that their decision-making power is non-derivative. In particular, shareholder primacy models incorrectly assume that

insolubly characterized by perpetual conflicts among self-interested and opportunistically motivated[120] corporate constituents. To manage those conflicts—which present a perennial, systemic risk to the internal cohesion, adaptability and, thus, prosperity and ultimate survival of the firm—corporate law is necessarily called upon to allocate infinite and absolute decision-making authority within one core group of corporate constituents.[121] American corporate law is *unmistakably* clear as to the identity of this single core group of corporate constituents: the board of directors.[122] As a result, I have argued that the well-advised, disinterested board of a Berle-Means corporation is uncontrollable in absolute terms.[123] In other words, my *absolute director primacy model*, unlike all other microtheoretical models of the firm, explicitly *denies* that any meaningful measure of director accountability exists in American corporate law.[124] Such a conclusion with

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the decision-making authority of corporate boards is derivative, *i.e.*, delegated to corporate boards by the shareholder franchise—at least, through the mechanism of board elections during which shareholders vote. *See* Mike Martin, *The Crisis of Shareholder Primacy*, UNIV. OF CAMBRIDGE (Mar. 19, 2012), http://www.cam.ac.uk/research/discussion/the-crisis-of-shareholder-primacy/. This assumption ignores the *de lege lata* reality of board authority. *See* DEL. CODE ANN. tit. 8 § 141(a) (2011); DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

[120]Williamson, *supra* note 13, at 458 (differentiating opportunism from mere (plain-vanilla) self-interest by describing "opportunistic agents [as] given to self-interest seeking with guile").

[121]*See* ARROW, *supra* note 1, at 69 ("Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success."); Allen, *supra* note 54, at 1400; Bainbridge, *Means and Ends*, *supra* note 65, at 552; Dooley, *supra* note 8, at 466.

[122]DEL. CODE ANN. tit. 8, § 141(a); *see also* MODEL BUS. CORP. ACT § 8.01(b) (2011) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors . . . ."). Under the corporation statutes of all states, corporations are managed by or under the direction of a board of directors as the statutory default rule. *See, e.g.*, Gevurtz, *supra* note 87, at 92 ("Th[e] board-centered model of corporate governance is not only the universal norm in American corporate law, it is also the prevailing model of corporate governance around the world.").

[123]Reich-Graefe, *supra* note 6, at 358, 400.

[124]It should be noted that this statement is only made with regard to the agency (cost) problem of directorial shirking, not the more controlled and controllable agency (cost) problem of directorial stealing. In other words, directors are granted full discretion to act opportunistically—unfettered by any *ex-ante* or *ex-post* legal constraint—and to favor any particular cause or firm participant interest over any and all others at any point in time as long as (i) no controlling economic self-interest of directors is actualized (and remains unsanitized) in the decision, (ii) very minor and basic process due care is complied with, and (iii) some rudimentary (and, possibly, entirely hypothetical) rational basis and explanation can be construed as to why the prevailing consensus at the time of the board action might have been that the corporation could ultimately benefit in some (tangible or intangible) shape or form. *See, e.g.*, BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 110 (concluding that pursuant to the effects of the business judgment rule, corporate directors are given "carte blanche to make decisions that might turn out badly, but no discretion to make selfish decisions"); Blair & Stout, *Introduction*, *supra* note 8, at 746 (stating that "as a matter of law [the board] remains insulated from the direct command and control of [shareholders and management] or

regard to the *authority* of corporate directors, of course, begs the question of how we ensure that corporate directors nonetheless remain *accountable* for their exercise of authority (*i.e.*, their institutionalized power granted by statute). As has been articulated in a different context: "[t]he key is that unless there is accountability, we will never get the right system. As long as there are no consequences . . . we're playing a game as to who has the power."[125]

Given the daily phenomenon of general investor confidence *pre-investment* in the face of absent director accountability *post-investment*[126] (and also, for the sake of this discussion, setting aside the question of whether we have gotten the system "right"), it is a simple and rather obvious deduction that some fairly effective enforcement agency restraining (and, where necessary, disciplining) absolute directorial decision-making power must somehow exist. No rational investor would otherwise participate in a firm knowing that its central decision-maker can always act opportunistically (and, thus, shirk on performance at random) and, nonetheless, always get away with it.[127] Significantly less simple and obvious, however, is the explanation behind the observable daily phenomenon of investor confidence. I have posited in this regard that a robust theoretical explanation of this phenomenon (and dilemma) is still missing from our current corporate governance debate:

> Neither current corporate law nor our microtheoretical models of the firm do (or, logically, can) explain the daily phenomenon of general investor confidence *ex-ante-investment* in the face of absent director accountability *ex-post-investment*—other than

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any other corporate constituents"); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1470 (2006); Stout, *Proper Motive*, *supra* note 18, at 6 (stating that "[t]he business judgment rule . . . allows a director who makes even a minimal effort to become 'informed' to make foolhardy decisions all day long, without fear of liability").

[125] Joel Klein, *The Failure of American Schools*, ATLANTIC, June 2011, at 8, *available at* http://www.theatlantic.com/magazine/archive/2011/06/the-failure-of-american-schools/308497/ (quoting Albert Shanker from his speech to the Pew Forum on Education Reform in 1993). In other words, only power coupled with sufficient and efficient measures of accountability can be legitimate. *See id.*

[126] *See supra* note 100.

[127] *See* Mitchell, *Trust. Contract. Process.*, *supra* note 8, at 191 ("Why would anybody invest money in a corporation, an institution over which she has no control?"); Stout, *Proper Motives*, *supra* note 18, at 9 ("Rational investors would never cede control of tens of trillions of dollars of assets to purely self-interested boards, given the tissue-paper thin protection offered by the rules of fiduciary duty, and the limits of social sanctions.").

> to assume ultimate control by some firm participant interests (for example, shareholder value), which is entirely illusory.[128]

We really have no good explanation (yet) as to how corporate directors, faced with almost limitless opportunities, make selections from a complete set of non-reviewable substantive options that are available to them pursuant to their absolute, *sui generis* decision-making power granted by corporate law. Neither do we have a good explanation (yet) as to how corporate directors are incentivized to repeatedly select available options "properly" and (supposedly) "do the right thing."[129] Accordingly, the explanation of the daily phenomenon of general investor confidence *pre-investment* in the face of absent director accountability *post-investment* remains the central, although unresolved, issue and dilemma in modern corporate governance theory.[130] I posit that any attempt of an explanation of this dilemma should focus on directorial *moral* behavior, *i.e.*, on the dialectic confrontation of a limitless range of opportunities in the reality of corporate practice with preexisting normative directorial preferences. Such internalized normative preferences seem to make all the difference and effectively motivate and, thus, control for "responsible" directorial behavior.[131] Which has brought me to the final question: What shapes and influences the internalization of normative directorial preferences?

I argue that such preferences are tightly controlled by largely unexplained and, thus, unaccounted for protolegal—even protonormative—behavioral constraints, by which I mean all those socio-contextual,[132] behavior-oriented, and reciprocal (normative) implications and foundations of interpersonal cooperation which are based on expectations and counter-

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[128] *See* Reich-Graefe, *supra* note 4, at 524; *see also* Reich-Graefe, *supra* note 6, at 395-98 ("[T]he *absolute director primacy model*—for the time being—not only results in a complete lack of ex-post accountability but, because of such lack of an accountability mechanism, also results in total ex-ante indeterminability."); *cf.* Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 274 (1991).

[129] *See* Grossman, *supra* note 31, at 465-66; Rock & Wachter, *Introduction*, *supra* note 105, at 1608; Stout, *Proper Motives*, *supra* note 18, at 9.

[130] *See* Stout, *Proper Motives*, *supra* note 18, at 9 ("[I]f we want to understand how boards of directors work, we need to develop a better understanding of the sorts of internal pressures encompassed by terms like 'honor,' 'integrity,' 'trustworthiness,' and 'responsibility.'").

[131] *See* Jones, *supra* note 7, at 124.

[132] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1768-69 (discussing how a given person's levels of trust may differ depending on the "social context" of the trust relation); Heminway, *supra* note 11, at 181 (discussing the role of gender as a part of the socio-contextual framework and stating that "the literature indicates with reasonable consistency that women are more trustworthy than men in a variety of test situations").

expectations.[133] All of this has brought me squarely to the co-existence of corporate law and *social norms* as enforcement agencies over the directorial decision-making behavior in Berle-Means corporations.

B. *Social Norms and Corporate Governance*

In general, four different types or categories of *external* regulatory constraints which influence and control human behavior can be differentiated and classified: law, markets, "architecture," and social norms.[134] The first three of those are not relevant for our current purposes. *Law* (including corporate governance law) is merely one of the available regulatory constraints on human behavior.[135] As has been explained above, corporate governance law—to the extent it applies to this inquiry—is vacuous and non-instrumental for purposes of directing and constraining corporate boards in their decision-making behavior.[136]

A second modality of regulation often referred to in the context of director primacy is *markets*, in particular "the market for corporate control."[137] Markets regulate and influence corporate decision-making behavior through the price mechanism.[138] When corporations are managed poorly, their stock prices will negatively reflect such underperformance.[139] Thus, the market for corporate control (*i.e.*, the hostile-takeover market[140]), as a post-investment corrective mechanism, will effectively address agency costs in the form of wasteful managerial shirking and/or rent-seeking by forcing corporate managers to run companies successfully (enough) so that

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[133] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1796; Miller, *supra* note 23 at 641; Mitchell, *Trust. Contract. Process.*, *supra* note 8, at 191; Stout, *Investor Confidence*, *supra* note 1, at 415-20.

[134] Lessig, *supra* note 45, at 662-63.

[135] *Id.* at 662.

[136] *See supra* notes 83-86 and accompanying text.

[137] *See* Lessig, *supra* note 45, at 663; Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965); *see also* Bainbridge, *Means and Ends*, *supra* note 65, at 562; Blair & Stout, *Explaining Anomalies*, *supra* note 73, at 724; Blair & Stout, *Team Production Theory*, *supra* note 73, at 252; Jones, *supra* note 7, at 119-20; David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 230; Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. 257, 276 (2010). *See generally* Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489, 489 (1999) ("Further evidence of interest in board behavior can be seen in the increased level of legal scrutiny to which boards are subjected and in the growing competitiveness of the market for corporate control.").

[138] Lessig, *supra* note 45, at 662.

[139] *See* Manne, *supra* note 137, at 112.

[140] *See* Pinto, *supra* note 137, at 276-79.

they do not become takeover targets because of mismanagement and ensuing underperformance.[141] In other words, it is claimed that "market forces adequately discipline [corporate] directors."[142]

In my judgment, however, this ex post market corrective does not help in any way regarding particular, specified firm investments to be made confidently ex ante. The reason for this is that the corporate-control-market corrective may help encourage some normative agenda across a wide spectrum of listed corporations ex ante (and, thus, incentivize firm managements across the same spectrum on average to comply with such agenda),[143] but it does not help the particular investor who ends up with particular, disincentivized, or "non-incentivizable" firm management and who is forced to (financially) suffer through the corrective market mechanism(s) coming to the "rescue" in her particular case in an attempt by the market to reinforce the normative agenda across the spectrum. In other words, the corporate-control-market corrective distributes highly inefficient monitoring costs asymmetrically and is therefore, at best, an *inefficient* constraint on corporate management behavior. Unless our investor hedges against such particularized risk with a widely diversified portfolio, why would she confidently invest ex ante in any particular company? Furthermore, the availability of the takeover-market corrective is, at best, extremely spotty.[144] Any such market is always dependent on a minimum number of other market players (*i.e.*, established competitors or new market entrants, for example, private equity firms) which could become interested in snatching up an underperforming firm.[145] Without enough other players, the market's price mechanism simply cannot go to work.[146] Furthermore, even if enough other market players exist and become interested in principle, going through with all of the financial, legal, and promotional costs of succeeding with a hostile takeover may be cost-prohibitive under many conditions—particularly when the third-party debt and equity markets financing takeovers dry up during serious bear markets and economic recessions.[147]

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[141] *See* BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 75; Allen, *supra* note 54, at 1400; Blair & Stout, *Introduction*, *supra* note 8, at 745.

[142] Jones, *supra* note 7, at 119.

[143] *See* BAINBRIDGE, CORPORATE LAW, *supra* note 8, at 75.

[144] *See* Pinto, *supra* note 137, at 276.

[145] *See id.*

[146] *See id.*

[147] *See id.* at 271; Stout, *Mythical Benefits*, *supra* note 32, at 795 ("[S]tock is, counterintuitively, an illiquid investment. Although a single shareholder may be able to sell a small number of shares easily, when exploited shareholders try to sell en masse, the result is a predictable loss of value."). And all of this does not even take into account "the anti-takeover mechanisms permitted under state law [which] severely weaken the disciplinary power of the takeover

The third behavioral constraint on human behavior, without any normative bearing on the accountability of directorial decision-making, is what Lawrence Lessig has labeled "*architecture*:" the very basic feasibility limitations imposed on resources (physical, technological, budgetary, etc.), in both time and space, by the present circumstances and conditions under which decision-making and resultant action may only take place.[148] I can only do now or in the future what is physically feasible and subject to my control and influence at the time of my action.[149]

That leaves the fourth and last category of behavior constraints which is the only one of interest here: *social norms*.[150] Social norms differ from legal ones both with regard to their creation as well as their enforcement.[151] "[S]ocial norm[s] . . . [are] rule[s] that [are] . . . neither promulgated by an official source, such as a court or a legislature, nor enforced by the threat of legal sanctions . . . ."[152] and that are (as are all rules) designed to direct "desirable"[153] behavioral outcomes.[154] As "soft" rules (*i.e.*, normative expectations consolidated and vested over time within a particular community or sub-group thereof, thus, creating *moral* obligations among norm addressees), social norms are nonetheless regularly complied with since non-compliance would otherwise result in certain forms of social sanctions (*e.g.*, open critiquing, gossiping, shaming, ostracism, internalized feelings of guilt, or shame)[155] or would otherwise forgo certain forms of social benefits (*e.g.*, increased esteem, other reputational gains, enhanced

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threat." *See* Jones, *supra* note 7, at 121.

[148]*See* Lessig, *supra* note 45, at 663-67.

[149]*See id.* at 663.

[150]*Id.* at 662.

[151]*See id.*

[152]RICHARD A. POSNER, FRONTIERS OF LEGAL THEORY 288 (2001); Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 AM. ECON. REV. 365, 365 (1997); *See also* Kaushik Basu, *Social Norms and the Law*, *in* 3 P-Z THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 476, 476 (Peter Newman ed., 2002); Jon Elster, *Social Norms and Economic Theory*, 3 J. ECON. PERSP. 99, 100 (1989); McAdams, *supra* note 7, at 350-51; Miller, *supra* note 23, at 641; Cass R. Sunstein, *Social Norms and Social Roles* (Chicago John M. Olin Law & Econ., Working Paper No. 36 (2d Series), 1995).

[153]The "desirability" of certain behavioral outcomes—as an end for which the norm exists in the first place—can be traced, at least, in general terms to a (majoritarian) normative determination that the "norm tends to enhance the welfare of the members of a group that adopts it." Ellickson, *supra* note 4, at 537, 546.

[154]Robert D. Cooter, Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant, 144 U. PA. L. REV. 1643, 1656 (1996); Posner, *supra* note 14, at 1699.

[155]*See* Robert Axelrod, *An Evolutionary Approach to Norms*, 80 AM. POL. SCI. REV. 1095, 1097 (1986); Basu, *supra* note 152, at 476; Ellickson, *supra* note 4, at 540; Miller, *supra* note 23, at 641; *see also* Jon Elster, *Emotions and Economic Theory*, 36 J. ECON. LIT. 47, 64-68 (1998) (describing "[t]he Cost-benefit Model of Emotions").

opportunities to socialize, network, or trade).[156] Given the absence of formal, institutionalized rule-making processes and of governmental enforcement agents, the form of ordering in human relationships which is, thus, (predominately) subject to the influence, operation, and regulation of social norms can accordingly be characterized as "self-regulated" or "self-enforcing."[157]

It is this quality of socially-sanctioned, self-enforcing expectation exercises at the very heart of the operation of social norms that makes the phenomenon of trust and trusting so seemingly valuable and indispensible for (transaction-cost) efficient corporate governance and the control of my *absolute directorial primacy* model. Any business corporation, as a going concern, is characterized by a constant process of redistribution of material resources and information.[158] As a result, the balance of power and influence of firm participants constantly shifts—thereby continually opening the realm for opportunistic behavior of some (group of) firm participants at the cost of other firm participants.[159] Two principal responses have always existed in order to keep the ensuing agency costs at a minimum and to establish an efficient measure of accountability vis-à-vis intra-corporate actors: either, the corporation implements an ever-increasing formal system of internal control and regulation of firm participants,[160] or it relies on an informal environment built on trust, mutual support, and the pursuit of mutual interest among firm participants.[161] As has been discussed, the former response is not available for purposes of controlling absolute director primacy in the standard Berle-Means corporation.[162] Corporate boards are not subject to any formal regulation in their decision-making function.[163] Thus, existing measures of board accountability must be the result of the latter, a self-regulatory response to the corporation's fundamental principal-agent problem where social norm mechanisms—in particular, trust—fill in the role of corporate monitors and enforcers, a role which otherwise would be performed either (i) internally by hierarchical command-and-control structures or by contractually assumed responsibilities, or (ii) externally by dominant firm

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[156] *See* Ellickson, *supra* note 4, at 540; Jones, *supra* note 7, at 108.

[157] *See supra* notes 136, 150-56 and accompanying text.

[158] *See* TODEVA, *supra* note 1, at 76; Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1737.

[159] *See* TODEVA, *supra* note 1, at 76; Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1737.

[160] *Cf.* Roger C. Mayer et al., *An Integrative Model of Organizational Trust*, 20 ACAD. MGMT. REV. 709, 710 (1995).

[161] TODEVA, *supra* note 1, at 76.

[162] *See supra* notes 113-25 and accompanying text.

[163] *See id.*

participants (for example, a majority shareholder in a closely-held-corporation context) or by applicable legal accountability processes (for example, the fiduciary duty of loyalty).[164]

C. *Related Literature*

As has already been mentioned in the opening sketches above, current research on the intersection of trust and corporate governance (or corporate law in general) is rather scarce.[165] There is, however, a now well-established academic literature on law and social norms (including trust) as well as a momentum-gaining, solid interest in the phenomenon of trust itself within a variety of academic fields outside of law, including philosophy,[166] political theory,[167] history,[168] economics,[169] business administration,[170] sociology,[171] social anthropology,[172] and social psychology.[173] The diagram in Figure 1

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[164] *See* TODEVA, *supra* note 1, at 76; Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1737.

[165] *See supra* notes 104-10 and accompanying text.

[166] *See* Baier, *supra* note 19; Annette Baier, *Trust and its Vulnerabilities*, *in* 13 TANNER LECTURES ON HUMAN VALUES 109, 109-13 (1991); Annette C. Baier, *Trusting People*, 6 PHIL. PERSP. 166, 101 (1992); Karen Jones, *Trust as an Affective Attitude*, 107 ETHICS 4, 4-6 (1996); Bernard Williams, *Formal Structures and Social Reality*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 3 (Diego Gambetta ed., 1988).

[167] *See* Lawrence C. Becker, *Trust as Noncognitive Security about Motives*, 107 ETHICS 43, 43 (1996); John Dunn, *Trust and Political Agency*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 73, 73 (Diego Gambetta ed., 1988); Russell Hardin, *Distrust*, 81 B.U. L. REV. 495, 521-22 (2001) [hereinafter Hardin, *Distrust*]; Russell Hardin, *The Street-Level Epistemology of Trust*, 21 POL. & SOC'Y 505, 505-07 (1993); Russell Hardin, *Trustworthiness*, 107 ETHICS 26, 28-35 (1996) [hereinafter Hardin, *Trustworthiness*].

[168] *See* Pagden, *supra* note 27, at 127-26.

[169] *See* Abigail Barr, *Trust and Expected Trustworthiness: Experimental Evidence from Zimbabwean Villages*, 113 Econ. J. 614, 614 (2003); Ben-Ner & Putterman, *supra* note 1, at 523; Dasgupta, *supra* note 1, at 49; Harvey S. James, Jr., *The Trust Paradox: A Survey of Economic Inquiries into the Nature of Trust and Trustworthiness*, at *1 (Jan. 22, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=295743; La Porta et al., *supra* note 1, at 333; Williamson, *supra* note 13, at 453.

[170] *See* Child, *supra* note 1, at 274; Mayer et al., *supra* note 160, at 709; Daniel J. McAllister, *Affect- and Cognition-Based Trust as Foundations for Interpersonal Cooperation in Organizations*, 38 ACAD. MGMT. J. 24, 25-26 (1995); Bart Nooteboom et al., *Effects of Trust and Governance on Relational Risk*, 40 ACAD. MGMT. J. 308, 308, 320 (1997); Ring & Van de Ven, *supra* note 60, at 93.

[171] *See* FUKUYAMA, *supra* note 1, at 10; Lewis & Weigert, *supra* note 13, at 967; Niklas Luhmann, *Familiarity, Confidence, Trust: Problems and Alternatives*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 94, 94 (Diego Gambetta ed., 1988); Toshio Yamagishi et al., *Uncertainty, Trust, and Commitment Formation in the United States and Japan*, 104 AM. J. SOC. 165, 165-67 (1998).

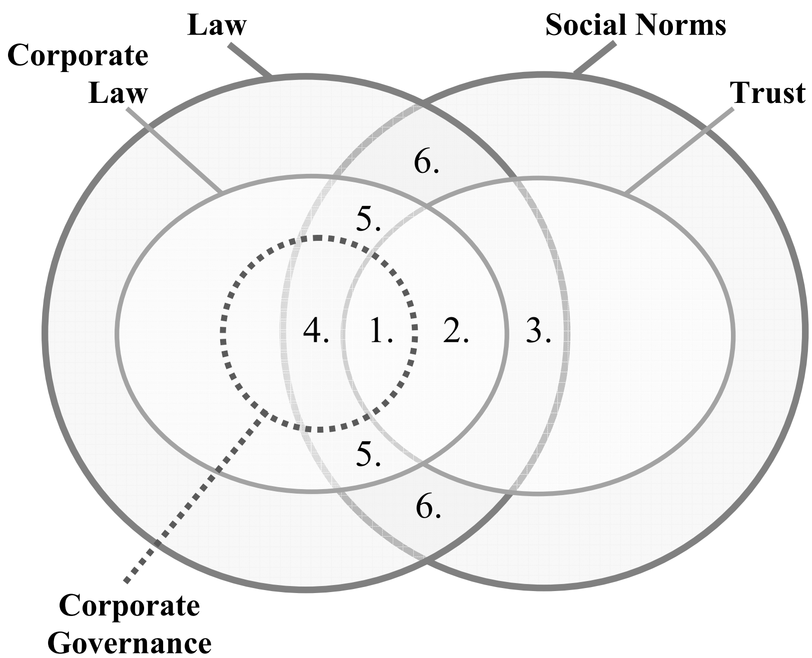
[172] *See* Ernest Gellner, Trust, Cohesion, and the Social Order, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 142, 142-43 (Diego Gambetta ed., 1988); Keith Hart,

orders and classifies—not exhaustively, but for purposes of an overview—the research done to date on the notion of trust from the perspective of, and starting with, the core focus of this Article *in medias res*—namely, the crossroads of trust and corporate governance.

Kinship, Contract, and Trust: the Economic Organization of Migrants in an African City Slum, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 176, 186-87 (Diego Gambetta ed., 1988).

[173] *See* Peter J. Burke & Jan E. Stets, *Trust and Commitment through Self-Verification*, 62 SOC. PSYCHOL. Q. 347, 347 (1999); Karen Schweers Cook, *Networks, Norms, and Trust: The Social Psychology of Social Capital*, 68 SOC. PSYCHOL. Q. 4, 6 (2005); Cook et al., *supra* note 2, at 21; David Good, *Individuals, Interpersonal Relations, and Trust*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 31, 31 (Diego Gambetta ed., 1988); Trudy Govier, *Self-Trust, Autonomy, and Self-Esteem*, 8 HYPATIA 99, 99 (1993); Toko Kiyonari et al., *Does Trust Beget Trustworthiness? Trust and Trustworthiness in Two Games and Two Cultures: A Research Note*, 69 SOC. PSYCHOL. Q. 270, 270 (2006).

Figure 1
The Situs of Trust And Corporate Governance



Overlaps:
1. Corporate governance and trust
2. Corporate law (other than corporate governance) and trust
3. Law (other than corporate law) and trust
4. Corporate governance and social norms (other than trust)
5. Corporate law (other than corporate governance) and social norms (other than trust)
6. Law (other than corporate law) and social norms (other than trust)

The six individual overlap areas identified in Figure 1, on aggregate, constitute the entire intersection of law and social norms. Note that each overlap area is not in proportion to the actual amount of literature in (corporate) law that studies the impact of social norms on (corporate governance) enforcement mechanisms. The general "*law and norms*" literature[174] (*i.e.*, the six individually numbered overlap areas in Figure 1

[174] *See* Jones, *supra* note 7, at 121-24; McAdams, *supra* note 7, at 343-50; Mitchell, *supra*

above combined)—which fully emerged in legal academia in the 1990s after Robert Ellickson's groundbreaking study, *Order Without Law*, published in 1991[175]—can be safely claimed to be pervasively well-developed today.[176] Within that general trend, less pervasive but still well-developed academic literatures have also become available in the areas of *corporate law and social norms*[177] and *corporate governance and social norms*[178] (constituting

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note 7, at 194-96.

[175] *See* ELLICKSON, *supra* note 7; *see also* Jones, *supra* note 7, at 121 ("The emergence of the 'law and social norms' movement can be traced to Robert Ellickson's book, *Order Without Law*.").

[176] For an overview of the "*law and norms*" literature, *see generally* ERIC A. POSNER, LAW AND SOCIAL NORMS (2000); Basu, *supra* note 152; David Charny, *Illusions of a Spontaneous Order: "Norms" in Contractual Relationships*, 144 U. PA. L. REV. 1841 (1996); Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643 (1996); Ellickson, *supra* note 4; Alex Geisinger, *A Group Identity Theory of Social Norms and Its Implications*, 78 TUL. L. REV. 605 (2004); Alex Geisinger, *Are Norms Efficient? Pluralistic Ignorance, Heuristics, and the Use of Norms as Private Regulation*, 57 ALA. L. REV. 1 (2005); Russell Hardin, *Law and Social Norms in the Large*, 86 VA. L. REV. 1821 (2000); Russell Hardin, *Magic on the Frontier: The Norm of Efficiency*, 144 U. PA. L. REV. 1987 (1996); Timur Kuran, *Ethnic Norms and Their Transformation through Reputational Cascades*, 27 J. LEGAL STUD. 623 (1998); Lessig, *supra* note 45; Lawrence Lessig, *Social Meaning and Social Norms*, 144 U. PA. L. REV. 2181 (1996); Saul Levmore, *Norms as Supplements*, 86 VA. L. REV. 1989 (2000); McAdams, *supra* note 7; Miller, *supra* note 23; Mitchell, *supra* note 7; Posner, *supra* note 14; Eric A. Posner, *Symbols, Signals, and Social Norms in Politics and the Law*, 27 J. LEGAL STUD. 765 (1998); Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 AM. ECON. REV. 365 (1997); Richard A. Posner, *Social Norms, Social Meaning, and Economic Analysis of Law: A Comment*, 27 J. LEGAL STUD. 553 (1998); Edward Rock & Michael Wachter, *Meeting by Signals, Playing by Norms: Complementary Accounts of Nonlegal Cooperation in Institutions*, 36 U. RICH. L. REV. 423 (2002); Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603 (2000); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903 (1996); *see also* Stewart Macauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963) ("[B]usinessmen often fail to plan exchange relationships completely, and seldom use legal sanctions to adjust these relationships or to settle disputes.").

[177] For an overview of the literature on *corporate law and social norms*, *see generally* John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151 (2001); Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253 (1999); Hart, *supra* note 31; Edward Rock & Michael Wachter, *Corporate Law as a Facilitator of Self Governance*, 34 GA. L. REV. 529 (2000); Rock & Wachter, *Islands*, *supra* note 89; Rock & Wachter, *Introduction*, *supra* note 105; David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811 (2001); Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955 (2001). Specific inquiries of the role of social norms in other (non-corporate) areas of the law include Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992); Jason Scott Johnston, *The Statute of Frauds and Business Norms: A Testable Game-Theoretic Model*, 144 U. PA. L. REV. 1859 (1996); Eric A. Posner, *Norms, Formalities, and the Statute of Frauds: A Comment*, 144 U. PA. L. REV. 1971 (1996).

[178] For an overview of the literature on *corporate governance and social norms*, *see generally* Cooter & Eisenberg, *supra* note 31; Cox & Munsinger, *supra* note 78; Elhauge, *supra* note 89; Samuel N. Fraidin, *Duty of Care Jurisprudence: Comparing Judicial Intuition and Social*

combined overlap areas *1.*, *2.*, *4.* and *5.*, and aggregated overlap areas *1.* and *4.* in Figure 1 above, respectively). In contrast thereto, only a few specific (and far from exhaustive) inquiries have so far been undertaken on the intersections of *law and trust*[179] in general and *corporate law and trust*[180] in particular (representing the aggregated overlap areas *1.*, *2.* and *3.*, and the combined overlap areas *1.* and *2.* in Figure 1 above, respectively). This leaves the final and most on-point intersection between corporate governance and trust (the overlap area numbered *1.* in Figure 1 above) and the dearth of academic study of such intersection, as already diagnosed at the beginning of this Article.[181]

None of the current legal literature on trust "pulls up" the (trans-) plant of trust in corporate governance by its very roots and undertakes to examine, investigate, and explain in plain (and perhaps cumbersome) detail the basic, yet fundamental structure and functional ingredients of trusting and its resultant effectiveness and value as a behavioral constraint and enforcement agency for purposes of (cheaply) controlling economic agency costs in the

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Psychology Research, 38 U.C. DAVIS L. REV. 1 (2004); Hazen, *supra* note 128; Johnson, *supra* note 32; Jones, *supra* note 7; Marcel Kahan, *The Limited Significance of Norms for Corporate Governance*, 149 U. PA. L. REV. 1869 (2001); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797 (2001); Lee, *supra* note 6; Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083 (2001).

[179]For an overview of the literature on *law and trust*, *see generally* Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457 (2005); George Dent, *Lawyers and Trust in Business Alliances*, 58 BUS. LAW. 45 (2002); Dent, *supra* note 38; Caroline Forell & Anna Sortun, *The Tort of Betrayal of Trust*, 42 U. MICH. J.L. REFORM 557 (2009); Tom R. Tyler, *Trust and Law Abidingness: A Proactive Model of Social Regulation*, 81 B.U. L. REV. 361 (2001); Hill & O'Hara, *supra* note 11; Dan H. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71 (2003); Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515 (2004); Mitchell, *Trust. Contract. Process.*, *supra* note 8; Eric A. Posner, *Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises*, 1997 WIS. L. REV. 567.

[180]For an overview of the literature on *corporate law and trust*, *see generally* Bukspan, *supra* note 11; Dean, *supra* note 11; Epstein, *supra* note 11; Ide & Yarn, *supra* note 11; Gregory Todd Jones, *Trust, Institutionalization, & Corporate Reputations: Public Independent Fact-Finding from a Risk Management Perspective*, 13 U. MIAMI BUS. L. REV. 121 (2005); Mitchell, *Being Trusted*, *supra* note 11; Mitchell, *Trust and Team Production*, *supra* note 9; Ribstein, *supra* note 4; Shleifer & Summers, *supra* note 11.

[181]*See supra* note 11 and accompanying text; *see also* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1754 ("[T]he role of trust behavior is both fundamental and largely neglected in the legal literature."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1758 ("[L]egal scholarship largely neglects the role of trust in firms, assuming instead that the best—indeed, only—way of controlling opportunistic behavior is through legal and market incentives . . . ."); Mitchell, *Fairness and Trust*, *supra* note 4, at 425 ("No matter how strong the legal rules requiring fiduciary loyalty are, no matter how successfully the market aligns a fiduciary's self-interest with corporate interest, trust is essential for corporate survival.").

corporate endeavor.[182] How can we utilize trust as a social norm in order to explain and predict economic behavior when we do not thoroughly understand how trust works in the first place? Accordingly, the examination, investigation and explanation of the transplant of trust in corporate governance—as far as the *mechanics of trusting* are concerned as well as their payoffs for trusting parties—will constitute the remaining inquiry of this Article.

III. THE PROBLEM OF TRUST: *MECHANICS*

Trust—as a real-world phenomenon, rather than an abstract idea—is a result of, and often a prerequisite for,[183] the process of any kind of human interaction.[184] In particular, trust is a cultivated[185] commodity for purposes of human (economic) cooperation.[186] Cultivation includes an element of time.[187] Time, and its passing, results in chronology. And favorable outcomes at the end of a given chronology of trusting (*i.e.*, those outcomes that meet the preferences, expectations and predictions of cooperating parties at the beginning of the same chronology[188]) require process.[189]

Process over substance is no stranger to corporate law.[190] The same basic approach is taken here with regard to the discussion of the problem of

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[182] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1779-80 ("We treat individuals as black boxes whose interior workings are unobservable.").

[183] *See* Gambetta, *supra* note 30, at 234.

[184] *See* Baier, *supra* note 19, at 231 ("Without trust, what matters to me would be unsafe, unless like the Stoic I attach myself only to what can thrive, or be safe from harm, *however* others act. The starry heavens above and the moral law within had better be about the only things that matter to me, if there is no one I can trust in any way.").

[185] Baier, *supra* note 19, at 233; Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1742 ("[T]rust may be a learned behavior."); Stout, *Investor Confidence*, *supra* note 1, at 421 ("[T]rust is learned.") (emphasis omitted); *see also* Cynthia L. Estlund, *The Changing Workplace as a Locus of Integration in a Diverse Society*, 2000 COLUM. BUS. L. REV. 331, 365 ("A workplace that cultivates long-term relations of cooperation and mutual trust and respect will also foster the sort of human connections that spill outside the workplace and enrich social life.").

[186] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1759.

[187] *Cf.* Dasgupta, *supra* note 1, at 53 ("[T]rust is based on *reputation* and that reputation has ultimately to be acquired through behaviour over time . . . .").

[188] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1772.

[189] *Cf.* Child, *supra* note 1, at 288 ("[Trust] is a dynamic phenomenon that evolves over a period of collaboration"); Ring & Van de Ven, *supra* note 60, at 100-01 (describing the process of the emergence of "cooperative interorganizational relationships" built on the transactional parties' "reliance on trust").

[190] For example, the writ system developed in medieval English common law made any judicially-sanctioned recourse against any party first and foremost dependent on the availability of a particular suit (or writ)—in other words, dependent upon whether a plaintiff was able to plead the necessary requirements of the writ and thus fit her case into the procedural vessel for redress. *See*

trust, namely, by focusing on *the mechanics* of trusting. Trust—as an abstract concept as well as a real-world phenomenon—defeats definition by means of simple prose.[191] Trust functions as a Band-Aid, which we humans use in order to bridge over our "bounded rationality"[192] and computational limitations for purposes of mapping out all possible future contingencies of our existence.[193]

If human life were akin to a game of chess,[194] "trust would not be a problem"[195] because it would be completely unnecessary and would have never developed as a central notion of human interaction and cooperation.[196]

Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 439 (1998) (discussing the common law writ system). Whether the plaintiff, in general (and, perhaps, in abstract terms), also had a *right* to redress was solely a derivative notion of successfully pleading a writ. *See id.* Substance only existed once and to the extent the procedure was met in its entirety. *See id.* Similarly, it can be stated that derivative shareholder suits in corporate law to this day follow a somewhat similar pattern and are reminiscent of the old procedure-over-substance approach of the English common law. Under the so-called "demand requirement" of corporate law (*see* Thomas P. Kinney, *Stockholder Derivative Suits: Demand Futility Where the Board Fails to Stop Wrongdoers*, 78 MARQ. L. REV. 172, 175 (1994)) in jurisdictions like Delaware and New York, "[a] stockholder filing a derivative suit must allege either that the board rejected his pre-suit demand that the board assert the corporation's claim or allege with particularity why the stockholder was justified in not having made the effort to obtain board action." *See* Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996) *overruled for different reasons by* Brehm v. Eisner, 746 A.2d 244, 244 (2000); Marx v. Akers, 666 N.E.2d 1034, 1063 (N.Y. 1996). "The shareholders must plead with particularity that they did not make demand because it would have been futile." Kinney, *supra*, at 175. No concern is given (or even allowed)—at this procedural demand-futility/summary-judgment stage—as to whether the corporate directors indeed violated any rights of the corporation in question. *See id.* at 175-76 ("Judicial economy is achieved by ending the need for a lawsuit."); *see also* Mitchell, *Fairness and Trust*, *supra* note 4, at 472 (discussing procedure over substance in the courts' fairness review of corporate director decision-making).

[191] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1735; Kiyonari et al., *supra* note 3, at 270 ("Beyond the acknowledgement that trust is important in social and personal life, however, there is not much consensus on the specific nature of trust and its functions in society."); Rousseau et al., *supra* note 14, at 394 ("To date, we have had no universally accepted scholarly definition of trust.").

[192] *See* Williamson, *supra* note 13, at 458 (defining "bounded rationality").

[193] *See* Gambetta, *supra* note 30, at 218; Good, *supra* note 173, at 46-47.

[194] *See* Good, *supra* note 173, at 46-47.

[195] Gambetta, *supra* note 30, at 218; *see also* Child, *supra* note 1, at 276 ("Trust is vital for any relationship, business or otherwise, when there is insufficient knowledge and understanding of the other person or group."); Dean, *supra* note 11, at 465 ("Trust is a matter of acting on imperfect information."); Dooley, *supra* note 8, at 465 ("If there were no bounded rationality, including no limitations on human foresight or the ability to acquire and process information, individuals could write completely specified contingent contracts."); Ide & Yarn, *supra* note 11, at 1118 ("Trust is not necessary when you can calculate how others will act accurately—the more accurate the calculation, the less trust required."); Lewis & Weigert, *supra* note 13, at 968; Rousseau et al., *supra* note 14, at 395 ("Trust would not be needed if actions could be undertaken with complete certainty and no risk.").

[196] *See* Becker, *supra* note 167, at 49 ("[E]ither I can compute the risk that what you say will be incorrect or I cannot. If I can, then what more do I need . . . ."); Cook et al., *supra* note 2, at 121

In a game of chess, there is *always* (i) only a finite total number of moves possible for purposes of the immediately next move, and (ii) only a finite total number of moves possible, counting all possible constellations of future moves, until the end of the game after the immediately next move.[197] Thus, in theory,[198] it would be possible, before each move, for players to quantify all remaining moves and to compute and consolidate the respective risk and reward probabilities for each remaining next move.[199] As such, players are able to discriminate among present possible moves (*i.e.*, present behavior options) based on an optimal prediction of the remaining possible (since finite) moves in the future (*i.e.*, future behavior options)—both of other and of self.[200] If every chess player sticks with the mathematically optimal next move (and makes no moves that are mathematically suboptimal, *i.e.*, based on such player's personal preferences and appetite for higher-risk strategies than mathematically optimal),[201] one can always predict, before any such next move, the future contingencies, including their attendant quantitative probabilities, of all remaining moves until the end of the game.[202]

Human life—unlike a game of chess (or any other game for that matter)—however, offers a (perhaps cruel)[203] ingredient which—in a fit of (existential) circular reasoning—may be called the very *raison d'être* of our human existence. By this I mean the ineluctable condition of human mortality (*i.e.*, our finite existence) under conditions of "Knightian uncertainty"[204] which (mercifully) destroys any meaningful computation of risks and rewards and with it, any purely utilitarian human orientation and sense-making in a world of limited resources, limited opportunities, and limited lifespan:[205]

("In the absence of monitoring and the sanctioning of opportunistic behavior, trusting always involves some risk."); Mayer et al., *supra* note 160, at 711 ("The *need* for trust only arises in a risky situation.").

197 *Cf.* Good, *supra* note 173, at 46-47.

198 Of course, this is under the (flawed) "assumption that computation is cost-free . . . [and] that decisions are made in a world where all problems have a close set of solutions . . . ." *See id.*

199 *See id.*

200 *See id.*

201 A game strategy which—together with the computational limitations of the human brain (*i.e.*, bounded rationality) (*see* Gambetta, *supra* note 30, at 218; Good, *supra* note 173, at 46-47; Williamson, *supra* note 13, at 458)—thankfully makes chess an interesting (repeat) game.

202 *See* Good, *supra* note 173, at 46-47.

203 In that the ingredient destroys the possibility for any meaningful mathematical computation of the utility of human existence (if any). *See id.*

204 *See* Belcher, at 24-25 (explaining "Knightian uncertainty").

205 *Cf.* Lewis & Weigert, *supra* note 13, at 968 (elaborating on the "temporal aspects of social life" which result in social complexity which, in turn, is decreased by trust).

> [T]here is no possibility of forming in any way groups of instances of sufficient homogeneity to make possible a quantitative determination of true probability. Business decisions, for example, deal with situations which are far too unique, generally speaking, for any sort of statistical tabulation to have any value for guidance. The concept of objectively measurable probability or chance is simply inapplicable.[206]

Since trust—as a substitute for the (impossible) objective quantification of the probability of future contingencies and, thus, their impact on present preferences and choices—is therefore such a universal device of human orientation in a world of absolute uncertainty,[207] it seems prudent to begin the analysis of trust—in the context of regulating (directorial) behavior for purposes of controlling socially beneficial behavioral outcomes—with the process of trusting[208] before venturing into a (rough) definition of "trust" and, thus, the substance of trusting itself.[209]

A. *The Process of Trusting*

Trusting—or, more precisely, the process, means and methods of reciprocally and efficiently signaling trustfulness and trustworthiness to others for purposes of enabling individual and specific instances of trusting to factually occur and work out successfully[210]—is, at best, a rather mysterious undertaking. For one thing, real-world trust is always dynamic[211] and never static. And what does not sit still is more difficult to observe and to study.[212] That being said, it is analytically possible (and necessary) to break down the process of trusting and to observe and explain three phases in the evolution of a trusting relationship: First, the phase of *pre-trusting*, when the parties to a future trust relationship get themselves ready and prepared to cooperate with each other; second, the phase of *in-trusting*, when the parties are in the process of consummating their trust relationship; and,

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[206] KNIGHT, *supra* note 7, at 231; *see also* Belcher, *supra* note 7, at 24-25.

[207] *Cf.* Luhmann, *supra* note 171, at 97.

[208] *See infra* Part III.A.

[209] *See infra* Part III.B.

[210] *Cf.* Siebecker, *supra* note 11, at 150 ("[T]rust remains tethered to specific situations.").

[211] *See* Belcher, *supra* note 11, at 153; Child, *supra* note 1, at 288 (describing trust as a "dynamic phenomenon"); Colombo, *supra* note 11, at 837; Mayer et al., *supra* note 160, at 728 (mentioning the "dynamic nature of trust").

[212] A fact which, for example, every birdwatcher can attest to only too well. *Cf.* Cook, *Networks, Norms, and Trust*, *supra* note 173, at 9 ("Trust relations are not easily studied in the laboratory . . . because they are inherently ongoing relations.").

third, the phase of *post-trusting*, during which the parties individually compare and evaluate their respective personal costs and benefits arising from trusting and cooperating.[213] During such post-trusting phase, the parties will also signal to each other their respective satisfaction (or dissatisfaction) with regard to their trust bonding with each other for purposes of cooperation.[214]

1. The Trust Exchange—*Take 1*

Trust is often misunderstood to (merely) involve a dyadic,[215] unidirectional[216] relationship consisting of (i) *A* having trust (in *B*) and, accordingly, being trusting (vis-à-vis *B*) on the one hand, and (ii) *B* being trustworthy (vis-à-vis *A*) and, accordingly, being trusted (by *A*) on the other hand.[217] To this, sometimes, is introduced a third element (but without changing the basic dyadic relationship between the trusting parties): the (tangible or intangible) object or matter (*C*) which is entrusted by *A* to *B* during an instance of consummated trusting.[218] Notwithstanding such

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[213] *See* Child, *supra* note 1, at 279-84 (distinguishing among three phases in the evolution of trust labeled (1) "Calculation" ["The Start"]; (2) "Understanding" ["Working Together"]; and (3) "Bonding" ["Building on Liking Each Other"]).

[214] *See* Ben-Ner & Putterman, *supra* note 1, at 538 ("If I interact with you and you do not let me down, I may raise my estimate of your trustworthiness, giving me an interest in interacting with you again.").

[215] *See* Russell Hardin, *Trust*, *in* 3 P-Z THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 623, 623 (Peter Newman, ed., 2002); *cf.* Burke & Stets, *supra* note 173, at 348 ("Self-verification leads to positive self-evaluations and positive other-evaluations in the form of dyadic trust, and trust facilitates attachment to the other."); Mayer et al., *supra* note 160, at 711; Oliver E. Williamson, *The Evolving Science of Organization*, 149 J. INST. & THEORETICAL ECON. 36, 56 (1993) ("Transaction cost economics mainly works out a dyadic setup.").

[216] Rather than reciprocal. *See* Mayer et al., *supra* note 160, at 729-30 ("[T]rust as considered in this model is unidirectional: from a given trustor to a given trustee."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1779 ("There may be some risk in assuming that the same variables that influence two-way trust necessarily apply to 'one-way' trust as well."); Hill & O'Hara, *supra* note 11, at 1729-30 ("[T]rust and distrust are assumed to lie along a unidimensional continuum."); Toshio Yamagishi & Karen S. Cook, *Generalized Exchange and Social Dilemmas*, 56 SOC. PSYCHOL. Q. 235, 245 (1993).

[217] Ben-Ner & Putterman, *supra* note 1, at 525 ("In this paper we investigate the meaning of trust, separating it into two elements: trusting (by A) and trustworthiness (of B)."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1745-46 ("[T]rust involves at least two actors—the actor who trusts and the actor who is trusted."); Ide & Yarn, *supra* note 11, at 1118 ("If *A* trusts *B*, *A* expects or believes that *B* will behave in an other-regarding manner that will not exploit *A*'s vulnerability.").

[218] Baier, *supra* note 19, at 236 (discussing trust as "a three-place predicate (A trusts B with valued thing C)"); Russell Hardin, *Do We Want Trust in Government?*, *in* DEMOCRACY AND TRUST 22, 28 (Mark E. Warren ed., 1999) ("A trusts B to do *x* (or with respect to *x*)."); Jones, *supra* note 166, at 17-18.

characterization of trusting as a three-*part* relationship,[219] the trusting of *A* in *B* with regard to *C* is always a two-*party* relationship (even if *C* is a person, for example, a baby to be baby-sat by *B*).[220] *A* and *B* are the (only) *subjects* that engage in, and consummate, the trusting relationship.[221] *C* is solely the *object* (and never a subject) of the trusting relationship between *A* and *B*.[222]

This basic dyadic cause-and-effect trusting process and undertaking between two parties is, however, only the beginning of the procedural structure of trusting which is significantly more intricate and complex:[223] Not only does *B* signal trust*worthi*ness to *A* (in the sense of "*I am willing to be trusted and worthy of being trusted.*"); *A* also signals to *B* trust*ful*ness (in the sense of "*I am willing to give trust and worthy of being trusted to trust.*")—an often overlooked aspect of the central reciprocity that undergirds the process (and substance) of trusting.[224] Trustworthiness and trustfulness are signaled and exchanged between *A* and *B* *before*, *during*, and *after* the consummation of any actions that include an actual, mutual instance of trusting.[225] Through the process of trusting and the resultant juxtaposition *and* quantification of (i) *pre-trusting* trustfulness of *A* (by *B*) as well as *pre-trusting* trustworthiness of *B* (by *A*) on the one hand, and (ii) *post-trusting* trustfulness of *A* (again, by *B*) as well as *post-trusting* trustworthiness of *B* (by *A*) on the other hand, each of *A* and *B* can individually compare and evaluate their respective personal utilities arising from the trusting relationship, once lived, in terms of either increases (net gains) or decreases (net losses) of trust and, thus, of respective increases or decreases of trustworthiness and trustfulness.[226]

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[219] Siebecker, *supra* note 11, at 149 ("[T]rust represents a three-part relationship."); Hardin, *supra* note 215, at 623 ("[T]rust is a three-part relation: A trusts B to do, or with respect to, X.").

[220] *See* Ermisch et al., *supra* note 3, at 751.

[221] *See id.*

[222] It is, of course, possible for *C* to simultaneously have her own binary trusting relationship(s) with *A* and/or *B* in addition to *A* trusting *B*—even with regard to herself as the object (for example, *C* trusting *A* with regard to *C*). *Cf.* Hardin, *supra* note 215, at 623 ("[T]rust is a three-part relation: A trusts B to do, or with respect to, X.").

[223] *Cf.* Lewis & Weigert, *supra* note 13, at 967 (describing "trust as an irreducible and multidimensional social reality"); Rousseau et al., *supra* note 14, at 394 (referring to the "complex (one might say 'multiplex') character of trust").

[224] *Cf.* Ide & Yarn, *Fact Finding*, *supra* note 11, at 1119 ("If *A* cannot trust *B* to reciprocate, then either *A* will not cooperate and will forfeit the potential benefits or *A* will expend resources to monitor and control *B* to ensure *B* reciprocates.").

[225] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1745-46 ("Trust and trustworthiness accordingly are closely linked, with the former depending upon an expectation of the latter.").

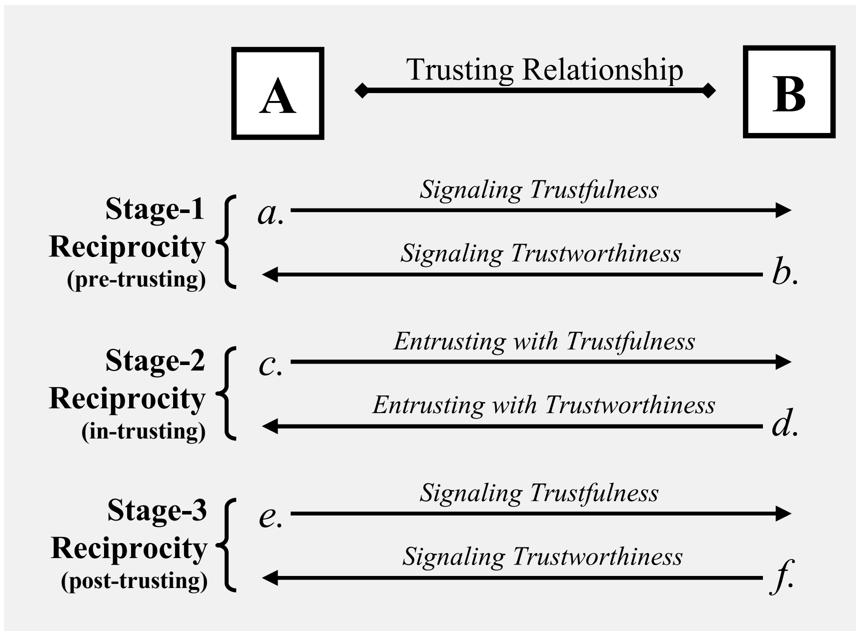
[226] *Cf.* Ide & Yarn, *Fact Finding*, *supra* note 11, at 1119 (describing how a trust relationship is either built or not consummated).

But that is still far from all: If the process of trusting constitutes an exchange transaction in which *A* and *B* trade existing *pre-trusting* levels of trustfulness and trustworthiness for *post-trusting* gains or losses of trustfulness and trustworthiness,[227] each signal and exchange of trust*worthi*ness *by each party* must also logically include a signal and exchange of trust*ful*ness *by the same party*—and vice versa—even if only on a higher level of abstraction.[228] Accordingly, three (somewhat chronological) stages of reciprocity can be distinguished for each of *A* and *B* with regard to any discreet exercise of trusting occurring in such a binary, two-party relationship. The following Figure 2 more schematically describes the basics of the resultant *six* separate structural positions existing among the reciprocities of pre-trusting ("*Stage-1 trusting*"), in-trusting ("*Stage-2 trusting*") and post-trusting ("*Stage-3 trusting*").

[227] *Cf.* Cook, *Networks, Norms, and Trust*, *supra* note 173, at 10-11 ("[T]rust is viewed as a 'by-product' of dyadic commitment. The commitment emerges as individuals in the exchange setting find partners they view as trustworthy—those who reciprocate or who negotiate fair deals, depending on the form of exchange involved.").

[228] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1750 ("If Ann believes that Beth's desire to behave trustworthily is strong enough to deter Beth from taking advantage of Ann, Ann may conclude it is safe to make herself vulnerable to Beth—that is, to trust Beth."); *id.* at 1772-73 ("[P]layers look to others' behavior as a signal in a novel and otherwise ambiguous social situation of what the appropriate norm of conduct is, and whether the context calls for primarily cooperative or competitive behavior."); Ide & Yarn, *Fact Finding*, *supra* note 11, at 1121 ("[P]eople are more likely to be trustworthy when other people trust them."); Lewis & Weigert, *supra* note 13, at 970 ("Each trusts on the assumption that others trust.").

Figure 2
The Procedural Reciprocities of Trusting



The claim made in Figure 2 with regard to a three-stage chronology of trusting only posits that (i) it is possible to differentiate those three stages of reciprocity and to conceptually treat them as separate from each other; (ii) the three stages occur in succession to each other; and (iii) each succeeding stage builds on the strength of the trusting reciprocity of its preceding stage(s)[229] so that all three stages are necessarily interconnected with, and interdependent of, each other. No claim is made that each stage requires completion before the next stage may begin. Furthermore, no lockstep exists between stages.[230] Thus, each stage can merge seamlessly into the

[229] *Cf.* Ide & Yarn, *Fact Finding*, *supra* note 11, at 1119 ("The more *A* can trust *B* to reciprocate, the less *A* must spend to ensure reciprocation or to punish *B*. One way interpersonal or mutual trust develops between individuals is through repeated interactions that allow the actors to generalize the expectation of continued cooperative behavior in subsequent interactions. Distrust arises when behavioral expectations are violated in one interaction so as to create a generalization to subsequent interactions, giving the violator a reputation for being untrustworthy.") (footnotes omitted).

[230] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1774 ("[T]he costs and

immediately next (or immediately preceding) stage. In addition, trust parties may decide—after commencing Stage-2 trusting (or Stage-3 trusting)—to return (temporarily) to Stage-1 (or Stage-2) trusting in order to shore up the likelihood of net increases at Stage-3 trusting. Finally, all three stages can (and often will) occur in extremely rapid succession, blending and merging together instantly. Still, for purposes of a theoretical understanding of the process of trusting, all three stages of trusting can be separated and distinguished from each other in order to show the inevitable and fundamental procedural element and character of trusting.

a. *Procedural Reciprocity—Stage 1: Pre-Trusting*

In their pre-trusting stage (Stage-1 trusting), before any *consummation* of their trusting relationship has begun, *A* is signaling trustfulness to *B* (= *a.* in Figure 2 above) and *B* is signaling trustworthiness to *A* (= *b.* in Figure 2 above). Since each signal and exchange of trustworthiness *by each party* also includes a mutual signal and exchange of trustfulness *by the same party*,[231] this preparatory Stage-1 reciprocity (of *A* and *B* getting *ready* to engage in consummating a trusting exercise with each other) can be further described separately (and differently) by focusing on the party, *A* or *B*, who engages in reciprocating behavior or—more precisely—who signals its willingness to engage in such reciprocating behavior at a later point in time during the process of trusting.

If the focus is on *A* as the reciprocating party:

> *1a.* *A* signaling Stage-1 trustfulness to *B* (= *a.* above) <u>translates into</u> *A*'s Stage-1 trustworthiness of *A* reciprocating *B*'s Stage-1 trustworthiness with Stage-2 trusting; and
> *1b.* *B* signaling Stage-1 trustworthiness to *A* (= *b.* above) <u>translates into</u> *B*'s Stage-1 trustfulness of *A* reciprocating *B*'s Stage-1 trustworthiness with Stage-2 trusting.

If we then invert the focus and put it now on *B* while *B* is in the process of signaling *B*'s willingness for future reciprocation:

> *2a.* *A* signaling Stage-1 trustfulness to *B* (= *a.* above) <u>translates into</u> *B*'s Stage-1 trustworthiness of *B* reciprocating *A*'s Stage-2 trusting with Stage-2 trustworthiness; and

benefits of trust behavior do not march in lockstep.").

[231] *See supra* note 228 and accompanying text.

2b. *B* signaling Stage-1 trustworthiness to *A* (= *b.* above) translates into *A*'s Stage-1 trustfulness of *B* reciprocating *A*'s Stage-2 trusting with Stage-2 trustworthiness.

Similarly, if the focus is not on the reciprocating party, but on how Stage-1 trusting appears to each party from its own perspective or vantage point, one ends up with a flip-side of the situation above: Stage-1 trusting from *A*'s perspective is now represented by *1a.* and *2b.* above, whereas Stage-1 trusting from *B*'s perspective is described in *1b.* and *2a.* above (in each case, with the latter reciprocity succeeding and being premised on the former).

b. *Procedural Reciprocity—Stage 2: In-Trusting*

By "procedural reciprocity" during the very stage in which *A* and *B* actually are in the process of consummating their trusting relationship, I mean that what is (reciprocally) trusted must exist and be observable, irrespective of the particular factual substance and social context of trusting,[232] and irrespective of the particular object of trusting (*i.e.*, irrespective of *C*). Thus, notwithstanding what the particular (tangible or intangible) object or matter of trust is which—external to *both* parties—gives rise and is subjected to the trusting relationship, *A* is entrusting *A*'s signaled Stage-1 trustfulness to *B* (= *c.* in Figure 2 above) and *B* is now trusting *A*'s trustfulness (including the build-in reciprocities of *1a.* and *2b.* above)[233]—while *B* is entrusting *B*'s signaled Stage-1 trustworthiness to *A* (= *d.* in Figure 2 above) and *A* is now trusting *B*'s trustworthiness (including the built-in reciprocities of *1b.* and *2a.* above).[234] In doing so, *A* and *B* have now agreed upon, committed to, and *locked in* their step-by-step plan of how (much) they will trust each other and consummate such trust. They have established between themselves a "*collective* cognitive reality"[235] that

[232] *See* Siebecker, *supra* note 11, at 150 ("[T]rust remains tethered to specific situations . . . [and] requires some attentiveness to particularity, to the circumstances within which people find themselves situated at any given time.").

[233] In other words, with *A* entrusting *A*'s Stage-1 trustfulness in *B*, *B* is now also trusting (i) *A*'s (continued) Stage-1 trustworthiness of *A* reciprocating *B*'s Stage-1 trustworthiness with Stage-2 trusting (= *1a.* above), and (ii) *A*'s (continued) Stage-1 trustfulness of *B* reciprocating *A*'s Stage-2 trusting with Stage-2 trustworthiness (= *2b.* above).

[234] Likewise, with *B* entrusting *B*'s Stage-1 trustworthiness in *A*, *A* is now also trusting (i) *B*'s Stage-1 trustfulness of *A* reciprocating *B*'s Stage-1 trustworthiness with Stage-2 trusting (= *1b.* above); and (ii) *B*'s Stage-1 trustworthiness of *B* reciprocating *A*'s Stage-2 trusting with Stage-2 trustworthiness (= *2a.* above).

[235] Lewis & Weigert, *supra* note 13, at 970.

operates (and creates benefits and costs) independent of the objective of their cooperation (and of the net increase or decrease of value which eventually accrues to each of them in regard to such objective and its achievement).[236] Furthermore, two additional procedural reciprocities occur during the entrusting exchange of *c.* and *d.* in Figure 2 above (again, depending upon which party's reciprocating behavior the focus is based).

> *1c.* *A* entrusting Stage-1 trustfulness to *B* (= *c.* above) <u>translates into</u> *A*'s Stage-2 trustworthiness of (i) *A* affirming *B*'s Stage-1 trustworthiness as well as (ii) *A* self-affirming *A*'s own Stage-1 trustfulness—both, during Stage-2 trusting; and
> *1d.* *B* entrusting Stage-1 trustworthiness to *A* (= *d.* above) <u>translates into</u> *B*'s Stage-2 trustfulness of (i) *A* affirming *B*'s Stage-1 trustworthiness as well as (ii) *A* self-affirming *A*'s own Stage-1 trustfulness—both, during Stage-2 trusting.
> *2c.* *A* entrusting Stage-1 trustfulness to *B* (= *c.* above) <u>translates into</u> *A*'s Stage-2 trustfulness of (i) *B* affirming *A*'s Stage-1 trustfulness as well as (ii) *B* self-affirming *B*'s own Stage-1 trustworthiness—both, during Stage-2 trusting; and
> *2d.* *B* entrusting Stage-1 trustworthiness to *A* (= *d.* above) <u>translates into</u> *B*'s Stage-2 trustworthiness of (i) *B* affirming *A*'s Stage-1 trustfulness as well as (ii) *B* self-affirming *B*'s own Stage-1 trustworthiness—both, during Stage-2 trusting.

It should be noted that what makes trust the powerful "glue"[237] (which so efficiently—and seemingly effortlessly—creates and holds cooperative relationships together) lies in this crossed-over and intertwined *reciprocity of simultaneous, symmetrical and identical other-affirmation and self-affirmation* in which each party engages. It is as if each party is simultaneously "dancing" with the other party and with itself (at least, in abstract terms). When *A* affirms *B*'s Stage-1 trustworthiness during Stage-2 trusting, *B*—at the same time and with instant feedback from *A*—self-affirms *B*'s own Stage-1 trustworthiness; when *B* affirms *A*'s Stage-1 trustfulness during Stage-2 trusting, *A*—at the same time and with instant feedback from *B*—self-affirms *A*'s own Stage-1 trustfulness.

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[236] *See* Siebecker, *supra* note 11, at 150.

[237] Ribstein, *supra* note 4, at 553; *see also* Ellickson, *supra* note 4, at 540 ("Much of the glue of a society comes not from law enforcement, as the classicists would have it, but rather from the informal enforcement of social mores . . . .").

c. *Procedural Reciprocity—Stage 3: Post-Trusting*

Finally, in their post-trusting stage (Stage-3 trusting), *i.e.*, after the consummation of their trusting relationship, *A* is signaling to *B* (and *B* is evaluating) *A*'s trustfulness (= *e.* in Figure 2 above) and *B* is signaling to *A* (and *A* is evaluating) *B*'s trustworthiness (= *f.* in Figure 2 above)—both, aggregate trustfulness of *A* and aggregate trustworthiness of *B* as modified (increased or decreased) by the process of their Stage-2 trusting in comparison to their respective ex-ante trustfulness and ex-ante trustworthiness during Stage-1 trusting. Similar to the discussion of the Stage-1 and Stage-2 reciprocities above, Stage-3 reciprocity (of *A* and *B* evaluating the *benefits* and *costs* resulting from engaging in the consummation of an instance of trust with each other) can now be further bifurcated depending on which party, *A* or *B*, engages in reciprocating.

> *1e.* *A* signaling Stage-3 trustfulness to *B* (= *e.* above) <u>translates into</u> *A*'s Stage-3 trustworthiness of (i) *A* affirming *B*'s Stage-3 trustworthiness as well as (ii) *A* self-affirming *A*'s own Stage-3 trustfulness—both, in result of Stage-2 trusting; and
> *1f.* *B* signaling Stage-3 trustworthiness to *A* (= *f.* above) <u>translates into</u> *B*'s Stage-3 trustfulness of (i) *A* affirming *B*'s Stage-3 trustworthiness as well as (ii) *A* self-affirming *A*'s own Stage-3 trustfulness—both, in result of Stage-2 trusting.
> *2e.* *A* signaling Stage-3 trustfulness to *B* (= *e.* above) <u>translates into</u> *B*'s Stage-3 trustworthiness of (i) *B* affirming *A*'s Stage-3 trustfulness as well as (ii) *B* self-affirming *B*'s own Stage-3 trustworthiness—both, in result of Stage-2 trusting; and
> *2f.* *B* signaling Stage-3 trustworthiness to *A* (= *f.* above) <u>translates into</u> *A*'s Stage-3 trustfulness of (i) *B* affirming *A*'s Stage-3 trustfulness as well as (ii) *B* self-affirming *B*'s own Stage-3 trustworthiness—both, in result of Stage-2 trusting.

Again, if the focus is not on which party engages in reciprocating behavior but how Stage-3 trusting appears to each party from its own perspective or vantage point, then Stage-3 trusting, from *A*'s perspective, comprises *1e.* and *2f.* above, and, from B's perspective, constitutes *1f.* and *2e.* above (unlike at Stage-1, however, here the latter reciprocity in each case occurs simultaneously with, and does not succeed and is not premised on, the former). Additionally, and as was the case with Stage-2 trusting above, we can also observe another occurrence of crossed-over and intertwined *reciprocity of simultaneous, symmetrical and identical other-affirmation and* *self-affirmation* as Stage-3 trusting takes on a calming effect. When *A* affirms *B*'s Stage-3 trustworthiness in result of Stage-2 trusting, *B*—at the same time and with instant validation feedback from *A*—self-affirms *B*'s own Stage-3 trustworthiness in result of Stage-2 trusting; when *B* affirms *A*'s Stage-3 trustfulness as a result of Stage-2 trusting, *A*—at the same time and with instant validation feedback from *B*—self-affirms *A*'s own Stage-3 trustfulness in result of Stage-2 trusting.

2. Payoffs from the Process of Trusting

The (psychological and structural) payoffs from the procedural reciprocities accruing to each party during the process of trusting are *enormous*.[238] What started out as a simple dyadic relationship set-up, involving solely "trusting (by A) and trustworthiness (of B),"[239] has resulted in a total of *ten reciprocities (comprising twenty individual reciprocal premises)* between *A* and *B* for a single, consummated instance of trusting in which *A* and *B* go through three distinct stages of reciprocal behavior (even if those three stages may happen at almost the same time).

Here is the full count and summary of the reciprocal premises described above, which *A* and *B* signal to and exchange with each other during a single instance of trusting:

Stage-1 trusting (<u>reciprocal behavior</u>: *A* is signaling Stage-1 trustfulness to *B* and *B* is signaling Stage-1 trustworthiness to *A*):

1.1 *A* can be trusted to reciprocate *B*'s Stage-1 trustworthiness with Stage-2 trusting (= *1a.* above).
1.2 *B* can trust *A* to reciprocate *B*'s Stage-1 trustworthiness with Stage-2 trusting (= *1b.* above).
2.1 *B* can be trusted to reciprocate *A*'s Stage-2 trusting with Stage-2 trustworthiness (= *2a.* above).
2.2 *A* can trust *B* to reciprocate *A*'s Stage-2 trusting with Stage-2 trustworthiness (= *2b.* above).

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[238] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1774-75 ("The experimental evidence indicates that it is in exactly these sorts of circumstances—when the individual cost of cooperation is relatively small and the benefits for others relatively large—that people are most likely to cooperate in a social dilemma.").

[239] Ben-Ner & Putterman, *supra* note 1, at 525 ("In this paper we investigate the meaning of trust, separating it into two elements: trusting (by A) and trustworthiness (of B).").

Stage-2 trusting (reciprocal behavior: *A* is entrusting his signaled Stage-1 trustfulness to *B* and *B* is entrusting his signaled Stage-1 trustworthiness to *A*):

3.1 *A* can be trusted to reciprocate *B's* Stage-2 trusting by affirming *B*'s Stage-1 trustworthiness (= (i) of *1c.* above).
3.2 *B* can trust *A* to reciprocate *B's* Stage-2 trusting by affirming *B*'s Stage-1 trustworthiness (= (i) of *1d.* above).
4.1 *A* can be trusted to reciprocate *B*'s Stage-2 trusting by self-affirming *A*'s own Stage-1 trustfulness (= (ii) of *1c.* above).
4.2 *B* can trust *A* to reciprocate *B*'s Stage-2 trusting by self-affirming *A*'s own Stage-1 trustfulness (= (ii) of *1d.* above).
5.1 *B* can be trusted to reciprocate *A*'s Stage-2 trusting by affirming *A*'s Stage-1 trustfulness (= (i) of *2c.* above).
5.2 *A* can trust *B* to reciprocate *A's* Stage-2 trusting by affirming *A*'s Stage-1 trustfulness (= (i) of *2d.* above).
6.1 *B* can be trusted to reciprocate *A*'s Stage-2 trusting by self-affirming *B*'s own Stage-1 trustworthiness (= (ii) of *2c.* above).
6.2 *A* can trust *B* to reciprocate *A's* Stage-2 trusting by self-affirming *B*'s own Stage-1 trustworthiness (= (ii) of *2d.* above).

Stage-3 trusting (reciprocal behavior: *A* is signaling Stage-3 trustfulness to *B* and *B* is signaling Stage-3 trustworthiness to *A*):

7.1 *A* can be trusted to reciprocate *B's* Stage-2 trusting by affirming *B*'s Stage-3 trustworthiness (= (i) of *1e.* above), thus, also validating B's Stage-1 trustworthiness.
7.2 *B* can trust *A* to reciprocate *B's* Stage-2 trusting by affirming *B*'s Stage-3 trustworthiness (= (i) of *1f.* above), thus, also validating B's Stage-1 trustworthiness.
8.1 *A* can be trusted to reciprocate *B*'s Stage-2 trusting by self-affirming *A*'s own Stage-3 trustfulness (= (ii) of *1e.* above), thus, also self-validating *A*'s own Stage-1 trustfulness.
8.2 *B* can trust *A* to reciprocate *B*'s Stage-2 trusting by self-affirming *A*'s own Stage-3 trustfulness (= (ii) of *1f.* above), thus, also self-validating *A*'s own Stage-1 trustfulness.
9.1 *B* can be trusted to reciprocate *A*'s Stage-2 trusting by affirming *A*'s Stage-3 trustfulness (= (i) of *2e.* above), thus, also validating *A*'s Stage-1 trustfulness.

9.2 *A* can trust *B* to reciprocate *A's* Stage-2 trusting by affirming *A*'s Stage-3 trustfulness (= (i) of *2f.* above), thus, also validating *A*'s Stage-1 trustfulness.
10.1 *B* can be trusted to reciprocate *A*'s Stage-2 trusting by self-affirming *B*'s own Stage-3 trustworthiness (= (ii) of *2e.* above), thus, also self-validating *B*'s own Stage-1 trustworthiness.
10.2 *A* can trust *B* to reciprocate *A's* Stage-2 trusting by self-affirming *B*'s own Stage-3 trustworthiness (= (ii) of *2f.* above), thus, also self-validating *B*'s own Stage-1 trustworthiness.

A normative analysis of the payoffs from the process of trusting should probably begin with the observation that the above twenty reciprocal premises involved in a single instance of trusting are significantly more than what could perhaps be seen as a tedious, unnecessary, even pedantic indulgence in semantics and academic over-analysis. Trusting is a mutual validation exercise in which expectations of trust (trustfulness or trustworthiness, respectively) and corresponding counter-expectations of trust (trustworthiness or trustfulness, respectively) are each exchanged between trusting parties.[240] At the same time parties also exchange, along with those expectations and counter-expectations of trust, built-in expectations and counter-expectations of other-affirmation and self-affirmation regarding each party's *identity* as a trustful, trustworthy, and trusting human being.[241] Thus, trust is, by necessity, an other-regarding phenomenon[242] for the very utility of self-affirmation and self-validation through (economic) cooperation.[243]

But trust is not only an extremely valuable commodity in this regard; it can also be an extremely *fickle*[244] and *fragile*[245] commodity. Each party

240 *See* Dasgupta, *supra* note 1, at 50-51; Ermisch et al., *supra* note 3, at 750.

241 *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1741-42 ("[H]uman beings do not behave in the strictly individualistic and self-interested way that economic theory often implies they do. Rather, they behave as if they sometimes have a preference or 'taste' for cooperative, other-regarding behavior generally and for trusting and trustworthy behavior specifically.").

242 *Cf. id.*; Heminway, *supra* note 11, at 179 ("[S]cholars have focused on other-regarding preferences . . . and risk-aversion as determinants of trustworthiness.") (footnotes omitted).

243 *See* Ermisch et al., *supra* note 3, at 750 ("[O]pportunities for mutually beneficial transactions are lost in societies in which people cannot trust each other.").

244 *See* Child, *supra* note 1, at 274 ("No partnership will work without trust, and it is one of the most difficult things to achieve.").

245 *See* Baier, *supra* note 19, at 238 ("One thing that can destroy a trust relationship fairly quickly is the combination of a rigoristic unforgiving attitude on the part of the truster and a touchy

could, in theory, revise its personal bundle of expectations and counter-expectations at any given point in time—in particular, mid-way into a trust relationship when the other party is potentially in its most vulnerable state.[246] As we all know from common experience, what we pejoratively term "breaches of trust"[247] can occur rather ubiquitously under repugnant conditions.[248] Thus, the *process* of trusting itself in which each party engages is designed to provide effective safeguards in order to minimize the risk of trust being breached. The principal tools for minimizing such downside risk are the ten procedural reciprocities set forth above. Their utility can be described in procedural terms of *bundling*, *splicing*, *looping* and *autopoiesis*.[249]

a. *Bundling of Trust Expectations*

Each of the twenty premises of procedural reciprocity outlined above is like an individual strand of fiber which gets woven with other strands into a thicker rope or cable. There is a set of ten reciprocal premises (or strands) for each *A* and *B*. During the process of trusting, each party's set of individual premises goes through a process of *bundling*. The premises are wrapped together by intertwining each party's own set of trust expectations and counter-expectations with each other. This *first-layer process* of *twisting*, *weaving* and *braiding* now results in what is already a much thicker (and heavier) rope with much more hanging on it—namely, the respective party's intertwined *expectations* and *commitments* (*i.e.*, self-expectations) to

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sensitivity to any criticism on the part of the trusted."); Colombo, *supra* note 11, at 842 ("[T]rust is often quite fragile, and . . . once broken, trust is hard to regain.") (internal quotation marks omitted); Gambetta, *supra* note 30, at 218 ("Trust is a tentative and intrinsically fragile response to our ignorance, a way of coping with the limits of our foresight . . . .") (internal quotation marks omitted); *see also* Good, *supra* note 173, at 46 ("Despite its apparent fragility and our many attempts to do without it, it is clear that, in many societies where it is well established, trust is remarkably robust.").

[246] *See* Baier, *supra* note 19, at 239 ("If part of what the truster entrusts to the trusted are discretionary powers, then the truster risks abuse of those and the successful disguise of such abuse."). This is the very dilemma of absolute director primacy discussed in the opening sketches above. *See supra* notes 91-94 and accompanying text.

[247] Sealy, *supra* note 49, at 69 (defining the same concept also as "breach[es] of confidence").

[248] Indeed, over the ages, the "business models" of con men have regularly involved breaches of trust vis-à-vis unsuspecting, trusting parties as the key ingredient to their functionality and success. *Cf.* Baier, *supra* note 19, at 234 ("Criminals, not moral philosophers, have been the experts at discerning different forms of trust.").

[249] Or "self-production." *See* Arthur J. Jacobson, *Autopoietic Law: The New Science of Niklas Luhmann*, 87 MICH. L. REV. 1647, 1647 (1989).

other-affirmation and self-affirmation via the trusting process with the other party.[250]

b. *Splicing of Bundled Trust Expectations*

Each party's interwoven bundle of trust expectations and counter-expectations (which constitutes their set of ten reciprocal premises of trustfulness and trustworthiness) could now be simply tied together with the other party's respective bundle by making a knot (or a series of knots). After tying a knot, however, there are still two pieces of rope. Depending on the kind of knot, untying can be a simple process and may even occur by unilateral action. Furthermore, knots have a tendency to break or to otherwise come apart before each of the individual pieces of rope will give way and rip apart.[251] Usually, the knot is the weakest point in a structure or relationship.[252]

Trusting knows no knotting. Knots are often not strong enough for successful (long-term) cooperation. Given (i) the thickness (*i.e.*, complexity) of each party's braided bundle of interwoven trust expectations and counter-expectations and (ii) the shortness of such bundle (*i.e.*, the amount of time parties may have to prepare, engage in, and evaluate their trusting), making a (proper) knot may not even be feasible.[253] Trusting, therefore, follows another, much more powerful and efficient technique (and metaphor): *splicing*. Splicing means to *unite*[254] the parties' ropes of expectations through a similar, *second-layer process* of *twisting*, *interweaving*, and *interbraiding* the strands of each party's bundled trust expectations—over the full length of whatever external and internal distance exists between the two parties. In other words, whatever length of rope each party can make available (with one end of such rope fastened to such party's very identity and existence)

[250] *Cf.* ARROW, *supra* note 1, at 41 ("Thus, it will be difficult to reverse an initial commitment in the direction in which information is gathered.").

[251] *See* Dario Meluzzi et al., *Biophysics of Knotting*, 39 ANN. REV. BIOPHYSICS 349, 357 (2010), *available at* biophys.annualreviews.org ("[I]t was shown that a linear polyethylene molecule with a trefoil knot breaks at a bond just outside the entrance of the knot, where the strain energy is highest, but is still only 78% of the strain energy needed to break an unknotted chain."); Piotr Pieranski et al., *Localization of Breakage Points in Knotted Strings*, 3 NEW J. PHYSICS 10.1, 10.2 (2001), *available at* http://iopscience.iop.org/1367-2630/3/1/310 [hereinafter Pieranski et al., *Localization of Breakage Points*] ("[A] rope is weakest just outside the entrance of the knot.") (internal quotation marks omitted).

[252] *See* Pieranski et al., *Localization of Breakage Points*, *supra* note 251, at 10.2.

[253] The shorter and thicker the individual rope bundles, the less likely that they can be physically knotted together.

[254] Unite ≠ untie.

will be used for purposes of splicing. Therefore, if both parties' individual ropes are about the same length, their individual ropes will now become *one single, spliced rope* with double the diameter and many times the strength and resistance of each individual bundle.

As a result, commitments of other-affirmation and self-affirmation are now no longer simply intertwined (in each party's individual bundle or rope); they are *interwoven* and *interconnected* within the same bundle. There is fusion, a new whole that is of a different quality compared to its constituent parts. *Expectations* mature into *predictions* of other and self-behavior.[255] Predictions of positive (*i.e.*, favorable since desired) outcomes further allow for (mutual) *confidence*[256] and, thus, overcome Knightian uncertainty.[257] The result is that trust—in particular, in its noncognitive form[258]—is a much stronger (and more intimate) connector between parties than any formal act of contracting could ever be.[259] Indeed, every formal contract will require a good (additional) measure of (undocumented, unspoken and unpromised) trust in order to be consummated.[260] Promises may easily be broken (and

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[255] *Cf.* Barr, *supra* note 169, at 627 ("[T]rusting behavior is motivated by expectations of trustworthiness."); Becker, *supra* note 167, at 45 ("Once we have beliefs and expectations about the trustworthiness of others, we can convert uncertainties about their behavior into an *estimate* of the risks of dealing with them.") (emphasis added); Ermisch et al., *supra* note 3, at 751 (mentioning "the *expectation* that the trustee will do X, framed in terms of a probability").

[256] *See* Burke & Stets, *supra* note 173, at 352 ("Trust also generates feelings of confidence and security in the relationship."); Child, *supra* note 1, at 275; Dunn, *supra* note 167, at 74-75 ("[T]rust as a modality of action may . . . convert a policy of trust into a condition of confidence."); Jones, *supra* note 180, at 133.

[257] *Id*. at 276 ("[T]rust is . . . a way of dealing with ignorance and uncertainty . . . ."). Such confidence that overcomes Knightian uncertainty appears to overlap significantly, if not, to equal the fundamental baseline of trusting which Eric Erickson has termed "basic trust" in developmental psychology (*see* ERIK H. ERICKSON, CHILDHOOD AND SOCIETY 247-48 (1963); *see also* Belcher, *supra* note 11, at 156) and which Lawrence Becker refers to as "noncognitive trust" in his political philosophy. Becker, *supra* note 167, at 44; *see also* Luhmann, *supra* note 171, at 97-98 ("[T]rust can revert to mere confidence . . . ."). In other words, this (constant repeat) experience of baseline confidence in how we look at this world and expect it to (not) change is existentially necessary because any complete exposure to Knightian uncertainty (which exposure would destroy *any and all* expectations about *any and all* future events) would likely be an irreversibly traumatic event for the human psyche. *Cf.* Mitchell, *Fairness and Trust*, *supra* note 4, at 432 ("Without trust, we would be overwhelmed by the world around us.").

[258] *See* Becker, *supra* note 167, at 44.

[259] *Cf.* Yongmin Chen, *Promises, Trust, and Contracts*, 16 J. L. ECON. ORG. 209, 227 (2000) ("There has been evidence that the lack of trust and thus the diminished role of incomplete contracts has been a cause of the slow economic development in some societies. There has also been evidence that trust promotes cooperation in large organizations where reputation effects tend to be weak.") (citations omitted).

[260] *See* Belcher, *supra* note 11, at 161. In other words, it can be claimed that every formal contract requires a congruent, contemporaneous "psychological contract" for purpose of successful consummation. *See* Ring & Van de Ven, *supra* note 60, at 100 ("Psychological contracts, as

breaching a promise may even be efficient[261])—trust never is. "*I trust you*" is a powerful manipulator of others and of self (and their respective future behaviors).[262] At the splicing-stage, trust can be described as a full-body embrace[263] (as compared to the contractual metaphor of a handshake).[264] And in an embrace, each party not only *embraces* and, thus, binds the other, but also—by necessity—*is embraced* and, thus, binds itself.[265] This process is an indispensible condition and prerequisite for the final layer of affirmation and self-affirmation of trusting to occur.

c. *Looping of Spliced Trust Expectations*

The embrace of trusting is not only external (*i.e.*, around the party, manipulating its behavior crudely), but internal as well (*i.e.*, within the party, manipulating its preferences and motivations which, in turn, manipulate its choices and behavior much more effectively).[266] In other words, trust, as shown in Figure 2 above, is a symbiotic process. And the reason for this can be described as the important "*looping*" aspect in the process of trusting. The starting point here is an examination of each party's interwoven bundle of trust expectations and counter-expectations from both ends. One end constitutes such party's five reciprocal premises of trustfulness. The other end comprises such party's five premises of trustworthiness. And, now, splicing does not happen just once, *but twice*: Each party's five premises of trustfulness are spliced together with the other party's five premises of trustworthiness—and vice versa.

No longer is one end of each party's rope fastened to the party's very identity and existence. Rather, both ends are fused together with the two

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opposed to most legal contracts, consist of unwritten and largely nonverbalized sets of congruent expectations and assumptions held by transacting parties about each other's prerogatives and obligations.").

[261] Ronald J. Scalise, Jr., *Why No "Efficient Breach" in Civil Law? A Comparative Assessment of the Doctrine of Efficient Breach of Contract*, 55 AM. J. COMP. L. 726, 722 (2007) ("[T]he theory of efficient breach of contract states that in some instances breaching a contract will be so profitable for the party who breaches that he will be able to compensate the other party so that neither will be worse off economically than if the contract had been performed.").

[262] *See* Kurt T. Dirks & Donald L. Ferrin, *The Role of Trust in Organizational Settings*, 4 ORG. SCI. 450, 456 (2001) [hereinafter Dirks & Ferrin, *Trust in Organizational Settings*] ("[T]rust affects how one *assesses the future behavior* of another party with whom one is interdependent.").

[263] *Cf.* Baier, *Trusting*, *supra* note 166, at 146 (*i.e.*, "hugging").

[264] *Cf. id.*, at 147 ("The handshake, that sacred sealer of deals, is a nice example of a gesture that combines trust and caution. It is the remnant of a mutually disempowering gesture, a mutual putting out of full action of the strong manipulative right hand.").

[265] *Cf. id.*

[266] *Cf.* Dirks & Ferrin, *Trust in Organizational Settings*, *supra* note 262, at 456-57 (describing how trust influences purpose which influences response).

ends of the other party's rope, creating a *single* seamless and continuous loop between the two trust parties. The loop runs through each party's entire identity, picking up core personal commitment for the process of trusting—that is, again, just the process irrespective of the particular substance and context of trusting and irrespective of the particular object of trusting (*i.e.*, irrespective of *C*).[267] Each party's identity, therefore, becomes exposed and vulnerable to, but also intimately connected with, and vested in, the other party's identity.[268] Each party is irreversibly invested in the other—even to the extent that "if subsequent information suggested that the initial choice [of trusting] was wrong, it would not pay to reverse the decision [to trust] later on."[269] Both parties' identities can now *cross-nurture* each other. *Predictions* mature into *validations* of other and self-behavior.[270] The potential fickleness and fragility of trusting discussed above are finally (and almost irreversibly) overcome.[271]

Furthermore, trust becomes *self-enforcing*. The perfectly reciprocal and interbraided other-validation and self-validation that forms the very core of the process of trusting has found its magical umbilical cord. Irrespective of substance, context, and object of trusting, the process of trusting has found its own end: to provide balanced cohesion and stability to a given trust relationship.[272] Cohesion here means that the structure of trusting established between the parties is holding steadily together *internally* and demonstrates a mutual, collective attachment and orientation towards the established relationship of trusting—any volatility of the constituent parts of the structure of trusting caused by (future) changes and resultant pressures in the preferences or tastes of the trusting parties is severely restrained.[273] In comparison thereto, stability means that the entire structure of trusting itself remains "firm" (*i.e.*, constant, durable, well-established, and secure[274])

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[267] *See supra* Part III.A.1.b (stating that the process of trusting is irrespective of trusted object *C*).

[268] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1739-40.

[269] ARROW, *supra* note 1, at 41.

[270] *Cf.* Burke & Stets, *supra* note 173, at 348 ("Self-verification leads to positive self-evaluations and positive other-evaluations in the form of dyadic trust, and trust facilitates attachment to the other. This attachment should reveal itself not only in commitment to the other but also in positive feelings for the other and, we anticipate, in a collective orientation to the relationship.").

[271] *See supra* notes 244-45 and accompanying text.

[272] *Cf.* Becker, *supra* note 167, at 58 ("A proper sense of security is a balance of cognitive control and noncognitive stability.").

[273] *Cf.* Burke & Stets, *supra* note 173, at 347 ("We suggest that the processes of establishing and maintaining self-verification contexts, and the positive self-feelings that result, lead to the development of interpersonal or group cohesiveness in the form of commitment, emotional attachment, and a collective orientation.").

[274] Etymologically, the word "firm" (from the Latin "*firmare*" [= to make firm] and "*firmus*"

externally vis-à-vis (future) changes and resultant pressures in both its very object of trusting (*C*) and its particular factual substance and social context in which the process of trusting is situationally embedded[275] (*i.e.*, the behavioral macro-constraint of "architecture" described above[276]).

d. *Autopoiesis*[277]

The process of trusting and the cohesion and stability of the trust relationship that is the result of this process still serve yet a larger purpose. (Economic) cooperation often requires extremely low transaction costs—otherwise, the particular cooperative behavior will not occur at all.[278] If cooperating parties were to be constantly told that the principle of *caveat emptor* controls their respective investments in the cooperative undertaking at issue, more inter-party monitoring, advance contracting, as well as renegotiation or litigation (in order to address incomplete contracting when faced with new, unforeseen conditions)[279] would be the likely result.[280] Such

[= chair, throne]—similarly, for example, in German "*Firma*") has exactly that reifying, stabilizing and solidifying meaning. *See* MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 471-72 (11th ed. 2003). It also means "the name or title under which a company transacts business," another distinct and exclusive way to denote the idea of something autonomously and independently existing in the marketplace above and beyond the existence of the individual firm participants. *See id.* at 472; *see also* Hale v. Henkel, 201 U.S. 43, 76 (1906) ("A corporation is, after all, but an association of individuals under an assumed name and with a distinct legal entity."); HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 18-19 (1996) ("[The] firm is in essence the common signatory of a group of contracts. In small firms organized as sole proprietorships, the individual proprietor signs these contracts. In a corporation or a partnership, the party that signs the contracts is a legal entity.").

[275] *Cf.* Dirks & Ferrin, *Trust in Organizational Settings*, *supra* note 262, at 456 (discussing trust correlates with how humans assess how others *will* act, assumedly regardless of externalities).

[276] *See supra* note 148 and accompanying text.

[277] *See supra* note 248 for a definition.

[278] *Cf.* Jean-François Hennart, *The Transaction Costs Theory of Joint Ventures: An Empirical Study of Japanese Subsidiaries*, 37 MGMT. SCI. 483, 484 (1991) (describing how transaction costs can be lowered through the use of joint ventures).

[279] Complete contracts do not exist. *See* Lewis & Weigert, *supra* note 13, at 968 ("It is not possible to develop plans of action which take into account all possible contingent futures."). (Complete) factual uncertainty with regard to the future always remains because of the "lack of knowledge of what the future will bring, [*i.e.*, because of the lack of knowledge] of all stochastic variables." Richter, *supra* note 8, at 175 n.22. Discussing the "gaps" in contracts, *see also* Alces, *supra* note 34, at 241-42; Bainbridge, *Means and Ends*, *supra* note 65, at 556 n.44; Meurer, *supra* note 32, at 739; *see also* Dooley, *supra* note 8, at 465 ("If there were no bounded rationality, including no limitations on human foresight or the ability to acquire and process information, individuals could write completely specified contingent contracts."); Gambetta, *supra* note 30, at 218 ("If we were blessed with an unlimited computational ability to map out all possible contingencies in enforceable contracts, trust would not be a problem.") (reference omitted).

[280] *Cf.* Dooley, *supra* note 8, at 464-65 (explaining that there is no such thing as no transaction costs).

transactional techniques, however, would often be unavailable because cooperative parties could not procure them efficiently under the limitations built into the nature of their cooperative undertaking. In other words, transaction costs would become too prohibitive and the entire transaction, the entire cooperative undertaking, would not occur since no party could satisfactorily deal with its individual downside risks resulting from engaging in the transaction.[281]

Enter *caveat emptor plus trust*: The magic of trust is that it is available at an extremely low transaction cost[282] (and further lowers overall transaction costs in terms of time and effort),[283] that *it exists*,[284] and that *it works*.[285] Why trust works—at least, from the perspective of the process of trusting—has been demonstrated above in the analysis of the *bundling*, *splicing*, and *looping* of trust expectations and counter-expectations.[286] The availability of trust at extremely low transaction costs is a result of a (final) process which has been described in terms of *autopoiesis*: trust creates itself. Trusting breeds more trusting.[287] When trusting occurs under favorable conditions (as far as substance, context, and conditions of trusting are concerned), the mechanics of trusting also ensure, in their final consequence, that trust becomes *self-referential* and *self-perpetual*.[288] Trust, when successfully exercised, self-affirms that trusting is existent, valuable, efficient, available at minimum transaction costs, and that it works (at least, most of the time).[289] Trusting parties mutually affirm to each other, and reciprocally self-affirm to themselves, that cooperation resultant from trust is

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[281] *Cf. id.* at 465-66 ("[T]ransaction costs, unless controlled, will frustrate achievement of the coalition's objectives.").

[282] Duggin & Goldman, *supra* note 11, at 257; Ermisch et al., *supra* note 3, at 749.

[283] Galston, *supra* note 1, at 130 ("The more trust, the lower the transaction costs."); Ring & Van de Ven, *supra* note 60, at 110 ("[T]he greater the ability to rely on trust, the lower the transaction costs (time and effort) required of parties to negotiate, reach agreements, and execute a cooperative [interorganizational relationship]."); Rousseau et al., *supra* note 14, at 394.

[284] Stout, *Investor Confidence*, *supra* note 1, at 421; *see also* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1738 ("[T]rust is a reality.").

[285] *Cf.* Dunn, *supra* note 167, at 73 ("Trust is . . . a modality of human action: a more or less consciously chosen policy for handling the freedom of other human agents or agencies."); Rousseau et al., *supra* note 14, at 395 ("[R]isk taking buttresses a sense of trust when the expected behavior materializes . . . .").

[286] *See supra* Part III.A.2.a-c.

[287] Dasgupta, *supra* note 1, at 56.

[288] *Cf. id.* ("[T]rust, like other moral resources, grows with use and decays with disuse[.]"); Child, *Fundamental Bond*, *supra* note 1, at 274 ("Of course, trust is itself likely to be reinforced by a successful relationship. This virtuous circle is an ideal one, if it can be obtained.").

[289] *Cf.* Child, *supra* note 1, at 274 ("[I]t is not surprising that people engaged in all areas of business and industry, and in every country, say they value trust and trustworthiness. At the same time, they recognize that it is not an easy thing to obtain.").

(morally) "good" and its fruits are, indeed, shared "values" (or shared individual "utilities") that each party is (morally) entitled to care about in an egocentric manner.[290] Trust, then, is the common denominator for attaining the equilibrium position of mutual (economic) cooperation among repeat players who could otherwise "punish defection in continual iterations of the game [of trusting] over time."[291]

The process of trusting which has developed from *expectations* (and *commitments*) to *predictions* and *validations* has finally arrived at (self-referential) *repetitions* and *experience*.[292] The consummation of a single, one-shot trusting relationship has already built into such relationship multiple repetitions of reciprocal exchanges of trustworthiness and trustfulness and multiple repetitions of reciprocal validations of trustworthiness and trustfulness. In other words, one successful trusting experience is already repetitively self-referential and creates a self-generated preference for future trusting (as opposed to future distrusting).[293] Thus, any

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[290] *Cf.* Galston, *supra* note 1, at 130 ("[Trust] is the expectation that arises within [a] community of regular and honest behavior based on shared norms, such as truth-telling, good intentions, reciprocity, and competence.").

[291] Siebecker, *supra* note 11, at 118; *see also* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1742 ("Defecting remains the optimal strategy for the self-interested player."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1762 ("Defection is the only sensible strategy for the rationally selfish player in . . . a 'one-shot' game."); Williamson, *supra* note 13, at 473.

[292] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1767 (discussing how willingness to trust can be influenced "by the weight of accumulated past experiences"); Ermisch et al., *supra* note 3, at 751; Hardin, *Trustworthiness*, *supra* note 167, at 27 ("Experience molds the psychology of trust.").

[293] It should be noted that one single trusting experience also already deals with what has been described as "a classic 'Catch-22': each party must induce her or his partner to be trusting before actually proving her own trustworthiness." Cook et al., *supra* note 2, at 122. Given the reciprocal signaling of both trustworthiness and trustfulness already in Stage-1 trusting as discussed herein, such process of pre-trusting effectively addresses the deadlock dilemma in initiating trust relations—*viz.*, who will make the first move unilaterally and expose herself to the risk of vulnerability. More properly conceptualized, it is not the "unilateral act of trust by one partner, . . . [which] is *required* to break the deadlock of a mutual lack of trust." *Id.* Rather, it is only the unilateral act of *signaling* trustworthiness and trustfulness during Stage-1 trusting and the (now much smaller) risk that such unilateral signaling act is rebuffed by the other side through a lack of reciprocal signaling of trustworthiness and trustfulness by such other side. This risk is now relatively small given that the consummation of the trust relation, *i.e.*, Stage-2 trusting or in-trusting has not yet commenced. In addition, resultant vulnerability which is the probability of any materialization of such risk is also already vastly reduced by the self-verification of trustworthiness and trustfulness through earlier (successfully consummated) trust experiences. *See supra* note 292 and accompanying text. As a result, Stage-1 trusting significantly minimizes the uncertainty of reciprocation by the party to be trusted (which, as explained herein, in Stage-1 trusting means already both parties to the trust relationship reciprocally) and, thus, mitigates, if not, marginalizes the dilemma of any Catch-22. In this way, the mechanics of trusting also explain why trusting is a genuinely autopoietic exercise and why, in final analysis, trust always creates itself—through the

repetition of the process of trusting is already *pre-validated* by the trusting experience of the past.[294] All repetitions, on aggregate, form a normative coral reef where each deposit produced by successful trusting shores up, stabilizes, and makes cohesive, the overall intrinsic value of trust as a "mechanism"[295] to reduce the social complexities[296] and (perceived) pitfalls of cooperative behavior and interaction.

The only remaining risk (or pitfall) that cannot be controlled by the process of trusting itself is the risk of betrayal[297] (or deceit;[298] or fraud;[299] or cheating;[300] or "being exploited";[301] or bad faith; or "ill will;"[302] or—simply—lying[303]). Here, (at least) one party to a purported trust relationship unilaterally schemes in order to exploit the vulnerabilities that the process of trusting exposes or creates in the other party (or parties) to such relationship by giving the impression of trustfulness, trustworthiness, and trusting (*i.e.*, by faking to engage in a genuine process of trusting). This constitutes a direct assault, targeted at trust, and an abuse of the process of trusting. It means that trust—as a *symbiotic* process—is clandestinely changed by (at least) one party into a *parasitic*[304] process.

However, it is important to keep in mind with respect to autopoiesis of trusting that, empirically, the process of trusting successfully happens literally thousands of times more often every single day for every single person (*i.e.*, there are literally thousands of *repetitions* of trusting across the entire spectrum of such person's daily activities) than any individual instance or scheme of betrayal would harm the same person during the same day.[305]

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very process of trusting—and, amazingly, already in just one single exercise of trusting. *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1768 ("If trust has proven adaptive for [an individual] in the past, she is likely to opt for trust again in the present . . . ."); Cook et al., *supra* note 2, at 139 ("We found some indication that allowing participants to signal their level of trust improves cooperation at least temporarily . . . ."); *see also* Kiyonari et al., *supra* note 3, at 282 ("In one-shot interactions, individuals have no way to build trust."); Yamagishi & Cook, *supra* note 216, at 240 ("The successful continuation of the system, however, requires that people already have a high level of mutual trust . . . .").

[294] *Cf.* Child, *supra* note 1, at 276.

[295] *Cf.* Mitchell, *Fairness and Trust*, *supra* note 4, at 432.

[296] In particular, the complex future contingencies of preferences, altered choices, and resultant behavior of others and self. *See* Luhmann, *supra* note 19, at 8, 24.

[297] *See* Baier, *supra* note 19, at 234; Williamson, *supra* note 13, at 482.

[298] *See* Burke & Stets, *supra* note 173, at 348.

[299] *See* Good, *supra* note 173, at 46.

[300] *See* Ermisch et al., *supra* note 3, at 751; Williamson, *supra* note 13, at 471.

[301] Ermisch et al., *supra* note 3, at 751.

[302] *See* Baier, *supra* note 19, at 238.

[303] *See* Sissela Bok, Lying: Moral Choice in Public and Private Life 242 (1978).

[304] *See* Hardin, *supra* note 215, at 624 ("For example, when a teenager says 'Trust me' with a grin, the phrase is parasitic on the theoretically interesting notion of trust, not an instance of it.").

[305] We might not be consciously aware all of the time of the fact that we are trusting, but we

Trust and successful instances of trusting are, by far, the empirical norm.[306] Trust, therefore, has significant benefits accruing to it.[307] The empirical exception of betrayal rarely materializes (at least, in its pure form of intentional deceitfulness targeted at abusing vulnerabilities of other parties which are exposed, or even created, by such parties because they were tricked into trusting).[308] Foregoing trusting entirely in order to avoid the risk of such exception materializing has significant costs associated with it—if it is even possible at all. The value of the benefits of trusting (even at low magnitude), when multiplied with the (very high) probability of their materialization, give trust and trusting an overwhelming competitive advantage as compared to the value of the potential costs of trusting (even at high magnitude) multiplied by the (extremely low) probability of their materialization. In other words, trust pays off[309] most of the time, if not always. Accordingly, people have an acquired preference[310] and path dependency[311] for living their lives in an all-pervading ambience[312] of trusting

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take for granted every day that the world around us continues to work pretty much as it did yesterday. We trust all the technologies we use around the clock (for example, alarm clocks, cell phones, credit card and other electronic financial systems, coffeemakers, refrigerators, any form of other electrical circuit, heating, stoves, cars, computers, internet, water supply, emergency services, etc.) and the people we encounter daily (for example, the drivers on the road, the colleagues at work, the friends and acquaintances we meet for lunch, for tennis after work, etc.) or whose services we use (for example, all those maintenance people who keep all the telephone, public transportation, public roads, financial, water, safety, heating, cooling, food distribution, building, trash removal, broadcasting, computer, internet and other services which we have become accustomed to and depend on dearly every single moment of our lives)—and that all of those technologies and all of the people behind them live up to our trust expectations of continuing to do what they are supposed to do. Modern human life and interaction without some basic form of trust is impossible. *See* Duggin & Goldman, *supra* note 11, at 256 ("The very act of living requires a basic level of faith in our ability to perceive the physical world and to understand both intellectual concepts and the complex interactions that comprise our social environment."); *see also* Lewis & Weigert, at 968-69 (discussing how the reduction of complexity through trusting becomes "possible if the cognitively expected probabilities of most of the contingently possible future events are thought of as zero for all practical purposes").

[306] *See supra* note 305 and accompanying text.

[307] *See supra* note 238 and accompanying text.

[308] *See supra* notes 297-303 and accompanying text.

[309] *See* WILLIAM SHAKESPEARE, MACBETH act 1, sc. 4 ("The service and the loyalty I owe, In doing it, pays itself."); *see also* Cooter & Eisenberg, *supra* note 31, at 1728 (stating that "insightful subordinates are more likely to attach themselves to superiors with good firm character, who will repay their trust"); Gambetta, *supra* note 30, at 234 ("Trust, even if *always* misplaced, can never do worse than [sustained distrust], and the expectation that it might do at least marginally better is therefore plausible."); Ribstein, *supra* note 4, at 553 ("Trust is a kind of social glue that allows people to interact at low transactions costs.") (footnote omitted).

[310] *Cf.* Blair & Stout, *Director Accountability*, *supra* note 11, at 439 ("[P]eople's behavior sometimes 'reveals a preference' for taking account of others' interests in making decisions.").

[311] *Cf.* Rousseau et al., *supra* note 14, at 395 ("The path-dependent connection between trust and risk taking arises from a reciprocal relationship: risk creates an opportunity for trust, which leads to risk taking.").

and trust and will prefer to engage in trusting, accordingly, instead of being stuck with constant suspicion, distrust, and worry of being let down or manipulated.[313] Given the choice, people distrust *distrust*[314] and are selectively fatalistic[315] towards the benefits (and associated risks) of trusting and the costs (and associated returns) of distrusting.[316] In the words of the late Niklas Luhmann:

> You cannot live without forming expectations with respect to contingent events and you have to neglect, more or less, the possibility of disappointment. You neglect this because it is a very rare possibility, but also because you do not know what else to do. The alternative is to live in a state of permanent uncertainty and to withdraw expectations without having anything with which to replace them.[317]

B. *The Substance of Trusting*

As has been expounded above, the notion and substance of trust and trusting defeats any attempts at snippet definition by means of simple prose.[318] Oftentimes, scholarship on trusting will also breach into what I call the "normative sphere" of trust in that it limits any discussion of trust and trusting to a virtuous, civil society-minded perspective of the same.[319] In this

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[312]*See* Baier, *supra* note 19, at 234 ("We inhabit a climate of trust as we inhabit an atmosphere and notice it as we notice air, only when it becomes scarce or polluted.").

[313]*See id.* ("Of course we are often disappointed, rebuffed, let down, or betrayed when we exhibit such trust in others, and we are often exploited when we show the wanted trustworthiness. We do in fact, wisely or stupidly, virtuously or viciously, show trust in a great variety of forms, and manifest a great variety of versions of trustworthiness, both with intimates and with strangers.").

[314]*Cf.* Gambetta, *supra* note 30, at 234 ("Once distrust has set in it soon becomes impossible to know if it was ever in fact justified, for it has the capacity to be *self-fulfilling*, to generate a reality consistent with itself. It then becomes individually 'rational' to behave accordingly, even for those previously prepared to act on more optimistic expectations.").

[315]*See* Cass R. Sunstein, *Selective Fatalism*, 27 J. LEGAL STUD. 799, 799 (1998) ("Human beings are selectively fatalistic. Some risks appear as mere 'background noise' and do not create much concern even if their magnitude is relatively high."); *see also* Baier, *supra* note 19, at 234 ("We put our bodily safety into the hands of pilots, drivers, doctors, with scarcely any sense of recklessness. We used not to suspect that the food we buy might be deliberately poisoned, and we used to trust our children to day-care centers.").

[316]Or, according to Kenneth Arrow, "the random accidents of history . . . play a bigger role in the final equilibrium" of the personal investment in trusting and trust. *See* ARROW, *supra* note 1, at 41.

[317]Luhmann, *supra* note 171, at 97.

[318]*See supra* note 191 and accompanying text.

[319]*See, e.g.*, Galston, *supra* note 1, at 130 ("The seedbeds of [trust] . . . are neither economic nor political institutions but, rather, the voluntary associations of civil society, starting with (but extending beyond) the family.").

vein, trust has been described with "the expectation that arises within [a] community of regular and honest behavior based on shared norms, such as truth-telling, good intentions, reciprocity, and competence."[320]

The following discussion of definitional elements of trust and of the substance of trusting does not follow this normative perspective or approach. Trust itself is a value-neutral,[321] if not, a normatively, morally vacuous phenomenon.[322] It is entirely dependent on its actors and their respective preferences and motivations.[323] Morally "good" and morally "bad" forms of trust exist.[324] Trust can be wed to shared virtues and can enhance "good" results (= moral trust); it can be used to further mutual vices and "bad" values (= immoral trust).[325] Accordingly, a discussion of the substance of trusting can be (and, arguably, first must be) divorced from the values or norms that trust is regularly employed to support. In other words, it can be divorced from the *morality* of trust relationships, thus, from a moral theory of trust.[326]

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[320] *Id.*

[321] *Cf.* Gambetta, *supra* note 30, at 213-14 ("The unqualified claim that more cooperation than we normally get would be desirable is generally sterile, is often characterized by irritating rhetorical flabbiness and, if preached too extensively, may even have the effect of making cooperation less attractive . . . . We may want *less* cooperation (and trust) rather than more, especially among those who are threatening us, and whose cooperation is a hindrance to ours.") (footnote omitted).

[322] *Cf.* Hardin, *Trustworthiness*, *supra* note 167, at 28 ("Independently of whether there is something moral about being trustworthy or untrustworthy, however, trust might be fully explicable as a capability or as a product of rational expectation without any moral residue.").

[323] Even further, cognitive trust may only be conceived as a purely positive phenomenon. In that regard, trust is similar to knowledge and, thus, independent of actors' preferences and choices. One either knows (trusts) or does not know (trust). *See* Hardin, *supra* note 215, at 624 ("If trust turns on expected incentives of others, then trust is in a cognitive category with knowledge. I do not choose to trust. Rather, once I have relevant knowledge, that knowledge constitutes my trust or distrust.").

[324] Baier, *supra* note 19, at 231-32 ("Exploitation and conspiracy, as much as justice and fellowship, thrive better in an atmosphere of trust.").

[325] *See* Baier, *supra* note 19, at 232 ("There are immoral as well as moral trust relationships, and trust-busting can be a morally proper goal."); Baier, *Trusting*, *supra* note 166, at 137 ("Those who are worthy of the trust of their co-workers in say the drug business, or are loyal gang members, are not necessarily the better for their trustworthiness, and those who put their trust in those who perpetuate exploitation or domination are not to be admired for their willingness to trust."); Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 AM. J. SOC. 481, 492 (1985) ("Force and fraud are most efficiently pursued by teams, and the structure of these teams requires a level of internal trust—'honor among thieves'—that usually follows preexisting lines of relationship."); Ring & Van de Ven, *supra* note 60, at 110 ("[T]he seeds for disintegration of relationships are contained in the very governance structures, safeguards, and processes that lead to their formation and growth.").

[326] *See* Baier, *supra* note 19, at 232 ("If we are to tell when morality requires the preservation of trust, when it requires the destruction of trust, we obviously need to distinguish different forms of

This Article is only concerned with the (positive or descriptive) *mechanics* of trusting (as a social norm and enforcement mechanism in itself)—not the normative *virtues*[327] of trusting from a perspective of overall social utility—and with the insights that may be gained from the mechanics of trusting to better predict the confidence of firm participants investing in firms that allow and guarantee their principal decision-makers absolute discretionary power over the investments made by others. Of course, we want those decision-makers to be competent, honest, regular in their behavior, to have good intentions and share norms of prudent and ethical business practices. But that is not the inquiry of this Article. Rather, the question is: why do we regularly engage in forms of trusting *with respect to* such virtues—why do we trust such virtues to exist within others and to guide their future behavior? Why do we—through our use of the notion of trusting others—voluntarily[328] make ourselves vulnerable to potential (financial) harm caused by those very same other people acting opportunistically after our investment of trust? Part of the answer has already been provided by the prior discussion of the process of trusting and its payoffs,[329] specifically the *autopoietic* and self-referential reinforcement of trusting as a process which is beneficial and meaningful in and of itself.[330] What remains to be discussed in this Part is how the value-neutral substance of trusting—*i.e.*, the preferential and motivational drivers behind the mechanical parts of the phenomenon of trusting—help provide a more complete answer to the above question(s).

1. Trust (Mechanically) Defined

To use Kaushik Basu's language, "like cows, [trust is] easier to recognize than to define. Most existing definitions are suggestive rather than exact."[331] Heeding such warning, it seems prudent for purposes of the

trust, and to look for some morally relevant features they may possess.").

[327]*Cf.* Arrow, *supra* note 20, at 345 (listing trust among "what are in a slightly old-fashioned terminology called *virtues*").

[328]*See* Baier, *supra* note 19, at 240 (stating that trust has a "voluntarist . . . character"); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1746; Galston, *supra* note 1, at 130; Stout, *Mythical Benefits*, *supra* note 32, at 801.

[329]*See supra* Part III.A.2.

[330]*See* Child, *supra* note 1, at 275 (defining trust as "the willingness of one person or group to relate to another in the belief that the other's actions will be beneficial rather than detrimental, even though this cannot be guaranteed"); Mayer et al., *supra* note 160, at 712.

[331]Basu, *supra* note 152, at 476. *Cf.* Miller, *supra* note 23, at 641 ("The recent scholarship has failed to coalesce around a precise definition of the term 'social norm.'"); Posner, *supra* note 14, at 1699 ("The concept of a 'norm' is slippery, and scholars use it in different ways. I will begin by offering some definitions, and if they seem arbitrary, it at least can be said that this is a defect shared by all writings on this subject."); Siebecker, *supra* note 11, at 148 (diagnosing a "fundamental lack

following discussion to separate and individualize certain central and structural tenets (or ingredients) of the substance of trusting (*i.e.*, the substance of what *A* and *B* reciprocally exchanged in their three-staged process of trusting as *trust*, *trustfulness*, and *trustworthiness*)[332] and to analyze each such individual ingredient (or set of ingredients) first, before attempting to draw a more collective and inclusive picture of the substance of trusting.

a. *Exposure to, and Acceptance of, In-Trusting Vulnerability*

Cooperation is guided by mutually or reciprocally shared ends or objectives.[333] Ends, however, may not be met. Accordingly, cooperation inescapably requires cooperators' exposure to failure—both individual and collective failure (in the sense of failing to meet the objective(s) of cooperation). Failure to meet the ends of cooperation can have many causes. A critical cause of potential failure for purposes of trusting, however, is moral hazard.[334] Included in the shared benefits of cooperation from the trusting relationship are, of course, the payoffs from the process of trusting discussed previously.[335] In particular, I am referring to the autopoietic validation that trusting can be trusted, that trust, by itself is good, and that as a trustful and trustworthy person, one is good because one trusts (because one has trusted) and can be trusted (because one could be trusted).[336]

Each party to a trust relationship, in trusting, is therefore self-creating, *accepting*,[337] and exposing to the other(s), its vulnerability to ex-post

of consensus … with respect to what trust entails"); Williamson, *supra* note 13, at 453 ("'[T]rust' is a term with many meanings.").

[332] *See supra* Part III.A.

[333] Cooperating parties share the same objectives of cooperation mutually (e.g. car-pooling for a certain road trip). They share different personal objectives of cooperation reciprocally when those ends are non-identical but complementary to each other (e.g., buying and selling a house). In such a case, cooperating parties mutually share that which they share reciprocally, (*i.e.*, they mutually share the same objective of achieving their reciprocal, complementary, non-identical ends as a result of the same cooperation with each other, meaning that they both want to achieve the sale of the house, even though their individual goals are different).

[334] By which I mean the post-investment opportunistic behavior of cooperative counter-parties which unilaterally shifts either (i) some of the otherwise shared benefits of cooperation from the trusting party to the trusted, or (ii) some of the otherwise shared costs of cooperation from the trusted party to the trusting, or (iii) worse, both. *Cf.* Ring & Van de Ven, *supra* note 60, at 92-93 (stating that "adverse selection" and "moral hazard" "deal directly with uncertainty that will be transaction specific and directly related to a willingness of the parties to rely on each other's trustworthiness in the face of the specific kinds of circumstances that give rise to the possible occurrence of either . . . .").

[335] *See supra* note 238 and accompanying text.

[336] *See supra* Part III.A.2.

[337] *See* Baier, *supra* note 19, at 235; Cook et al., *supra* note 2, at 140; Rousseau et al., *supra*

opportunism,[338] which may destroy (some of) the benefits of trusting.[339] Not only could each party lose its respective investment in trusting; each could (and often will) be even worse off than in the status quo ex ante trusting (at least, already with regard to its trust in the process and predictive value of trusting).[340] In addition, built into this vulnerability is a further cognitive exacerbation of exposure to the risk of harm: a special sub-vulnerability exists that as part of the trusting relationship one will not even notice harm until it is too late because of the well-disguised ill will and abuse of discretionary power by the trusted party.[341] But even in situations where the trusting party can perfectly monitor the performance of the trusted party, trusting will be necessary (and only truly happen) in those situations in which (as will often be the case) the trusting party has irrevocably given away (near) absolute discretionary powers[342] over what is entrusted *before* any action of the trusted party occurs vis-à-vis the entrusted object of trust (*C*),[343] thereby creating an unresolvable (chrono-)logical dilemma for potential future injury that is unavoidable in absolute terms (unless one were to never cooperate with others).[344] Thus, the combined downside risks from the substance of trusting in the form of exposing oneself to in-trusting vulnerability (*i.e.*, vulnerability created by the very engagement in trusting) are already rather significant.

note 14, at 395 ("Trust is a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behavior of another.").

[338] Baier, *supra* note 19, at 235 ("Where one depends on another's good will, one is necessarily vulnerable to the limits of that good will. One leaves others an opportunity to harm one when one trusts, and also shows one's confidence that they will not take it."); Richter, *supra* note 8, at 179 (stating that the main problem of Williamsonian transaction cost economics is "ex-post opportunism").

[339] *Cf.* Mayer et al., *supra* note 170, at 712 ("Being vulnerable . . . implies that there is something of importance to be lost. Making oneself vulnerable is taking risk. Trust is not taking risk *per se*, but rather it is a *willingness* to take risk.").

[340] *Cf.* Ide & Yarn, *Fact Finding*, *supra* note 11, at 1119 (explaining how "distrust" arises).

[341] *See* Baier, *supra* note 19, at 239 ("The special vulnerability which trust involves is vulnerability to not yet noticed harm, or to disguised ill will."); Baier, *Trusting*, *supra* note 166, at 139-40 ("[Trust] is willingness to give discretionary powers, to postpone checking and accounting."); Hill & O'Hara, *supra* note 11, at 1787 ("[D]irectors are not apt to look for, and hence unlikely to find, evidence of untrustworthiness that causes them to update their trust assessments.").

[342] Baier, *supra* note 19, at 237.

[343] *See* Dasgupta, *supra* note 1, at 51 ("If I can monitor what others have done *before* I choose my own action, the word 'trust' loses its potency.") (emphasis added).

[344] *See* Baier, *Trusting*, *supra* note 166, at 139-40; Cook et al., *supra* note 2, at 121; Lewis & Weigert, *supra* note 13, at 968; Ring & Van de Ven, *supra* note 60, at 92.

b. *Exposure to, and Acceptance of, Pre-Trusting Vulnerability*

There is, however, an even more significant potential downside. In addition to *in-trusting* vulnerability (*i.e.*, ex-post opportunism that injures and (partially) denies the individual benefits of a particular trust relationship), the substance of trusting for cooperative purposes also has a deeper, more existential importance and motivation. Trust parties enter into trust relationships for purposes of cooperation because cooperation—in particular, where it is *not absolutely necessary* for purposes of subsistence and survival of the trust party in question—gives (common) "meaning"[345] to each trust party's (limited) life.[346] Each party to a trust relationship will often have accumulated, during its past lifetime, a diffuse set of *pre-trusting* vulnerabilities which are pre-existent to trusting (*i.e.*, which entirely precede, and exist independently of, the trusting relationship) but which utilize trusting for purposes of allowing each trust party to better manage, and cope with, its inevitable (since existential) perennial exposure to those pre-trusting vulnerabilities.[347]

To be more specific, trusting ultimately allows each party to a trust relationship to better manage, and cope with, its own mortality.[348] Death is a *certainty*, not a *risk*.[349] Its occurrence is inevitable, largely unpredictable and (not counting the possibility of suicide) ultimately uncontrollable. The risk of *instant* or *looming* death is a constant companion to life. Death, the end of life, is the only real vulnerability humans have built into themselves as living beings.[350] Every other vulnerability (e.g., an illness, a loss of money, a loss of a loved one) is ultimately only perceived and a derivative of the human fear of death and of the constant risk of sudden and instant materialization of mortality. Most, if not all, humans build up a good number of personal vulnerabilities over the course of their lives. A common

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[345] *Cf.* Rousseau et al., *supra* note 14, at 393.

[346] *See* Leslie, *supra* note 179, at 532 ("Trust is important—often essential—to many cooperative endeavors. This is true between individuals, between firms, and between governments. Community cannot exist without trust.").

[347] *See* Ribstein, *supra* note 4, at 559 (discussing how, under Diego Gambetta's theory, "the evolution of cooperation depends on . . . a willingness to believe in trustworthiness").

[348] *See* Mitchell, *Being Trusted*, *supra* note 11, at 610-11 ("And our recognition of this fact, even if it is largely subconscious, helps lead us to trust and to cooperate.").

[349] *Id.* at 610.

[350] One could argue that—at least, in absolute terms—death cannot be a true vulnerability since we all die some day. However, I assume that we all are—at least, to some extent—relativists in this regard because we believe that more of the "good" quality of life that we currently have (or earlier had) is better (at least, better than to stop right here), so that quantity always immediately translates into quality.

antidote (or counter-weight) to those vulnerabilities—which are merely caused by the fear of harm and the fear of pain—can be seen in attempts to make sense of being alive, to make one's life meaningful, to attempt living an authentic, genuine life—notwithstanding (and rather because, and in the face, of) mortality and its derivative vulnerabilities.[351] Cooperation with others, based on trust, is one such very powerful antidote.[352] All of this may (admittedly) appear more than just a bit esoteric at this stage. However, I will attempt to discuss below the very real psychological payoffs from exposing oneself to, *and exchanging*, pre-trusting vulnerabilities which can be seen as the most intimate and central motivators for why humans engage in cooperation which is not essential for survival and, thus, engage in the substance of trusting.

c. *Exposure to Good Will and Vulnerability to Ill Will*

At its heart, trust is about beneficence,[353] about doing good.[354] And it is genuine, sincere beneficence that matters here: doing good because it is truly meant and not faking it for appearances sake.[355] To be truly meant, beneficence requires trust parties to act with *bona fides*, to act (literally translated) in good faith.[356] And good faith requires that one is oriented

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[351]*See generally* RICHARD G. BENTON, DEATH AND DYING: PRINCIPLES AND PRACTICES IN PATIENT CARE 28 (1979) ("Philosophical considerations of death generally flow from larger conceptualizations that try to articulate mankind's purpose, goals, and role in a created universe, in an accidental universe, or in a mechanical universe."); *id.* at 29 ("Existentialism has generally treated death as the total end of man: a resolution into nothing. Existentialism has thus treated death as entry into a complete void or an unknowable phenomenon—as nonexistence. The existentialist emphasizes coming to terms with one's inevitable nonexistence.").

[352]*See* Mitchell, *Being Trusted*, *supra* note 11, at 610-11 ("[W]e are only human. And our recognition of this fact, even if it is largely subconscious, helps lead us to trust and to cooperate.").

[353]FitzGibbon, *supra* note 14, at 308 ("A fiduciary must be beneficent.").

[354]"Benefic" comes from the Latin roots "bene" and "facere," and is defined as "beneficent." *See* MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 106 (10th ed. 1993). "Beneficent" is defined as "doing or producing good." *Id.*; *see also* Mayer et al., *supra* note 170, at 718-719 ("A number of researches have included characteristics similar to benevolence as a basis for trust."). I should note that I do not use the term "good" here in any absolute (thus, normative) sense but only in mere relative (thus, descriptive) terms. In such latter terms, "doing good" is about improving or maintaining the well-being of others irrespective of whether such improved or maintained well-being is morally right or wrong.

[355]Mayer et al., *supra* note 170, at 718 ("Benevolence is the extent to which a trustee is believed to want to do good *to the trustor*, aside from an egocentric profit motive. Benevolence suggests that the trustee has some specific attachment to the trustor.").

[356]*See* MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 106 (10th ed. 1993); Lewis & Weigert, *supra* note 13, at 968 ("[Trust] is the mutual 'faithfulness' on which all social relationships ultimately depend.").

towards another with goodwill (*i.e.*, benign intent or benevolence)[357] and is willing and prepared to exercise such goodwill to the other person—even at some personal cost and, perhaps, sacrifice. In other words, it requires that one is genuinely "other-regarding."[358] The person who acts beneficently, in good faith, and exercises goodwill towards others is considered authentic.

The substance of trusting therefore involves reliance[359] by trusting parties "on another's good will, perhaps minimal good will."[360] Accordingly, and as already discussed more broadly above, trust is about making oneself dependent on another and giving such other person (discretionary) power to harm us, but in the (relative) confidence that such other person will (i) not exploit such power against us and harm us, and (ii) rather protect us from downside risk and, thus, use the power for purposes of mutually beneficial cooperative ends.[361] In other words, trust is "*accepted* vulnerability to another's possible but not expected ill will (or lack of good will) toward one"[362] *together with* a measured (and not necessarily reasonable), but *confident* expectation[363] that the other will exercise general goodwill towards one, in particular, already by reciprocating the goodwill of oneself exercised in first signaling and then extending trustfulness and trustworthiness to the other.

Combining everything that has been discussed so far for purposes of defining trust, it can be said that trust is a crucial sedative to overcome the fear of harm. All fear of harm is ultimately derivative of the fear of death. Thus, trust is not only a Band-Aid. It is also a powerful pain-killer. It

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[357]*See* Burke & Stets, *supra* note 173, at 347-48; Jones, *supra* note 166, at 4; Mayer et al., *supra* note 170, at 718-19.

[358]*See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1742 n.10, 1743; Stout, *Proper Motives*, *supra* note 18, at 23.

[359]Hardin, *supra* note 215, at 623 ("All standard accounts of trust assume that it involves reliance on someone or some agency."); *see also* ARROW, *supra* note 1, at 23 ("Trust is . . . extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word.").

[360]Baier, *supra* note 19, at 234; *see also* Burke & Stets, *supra* note 173, at 348 ("[T]rust is a belief that the other holds both goodwill and benign intent toward us."); Jones, *supra* note 166, at 4; Ring & Van de Ven, *supra* note 60, at 93.

[361]*See* Child, note 1, at 275; Jones, *supra* note 166, at 6 ("At the center of trust is an attitude of optimism about the other person's goodwill.").

[362]Baier, *supra* note 19, at 235 (emphasis added); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1739-40; Heminway, *supra* note 11, at 177; Mayer et al., *supra* note 170, at 712 (defining trust as "the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party"); Rousseau et al., *supra* note 14, at 395.

[363]Dasgupta, *supra* note 1, at 51 (defining trust as "correct expectations about the *actions* of other people that have a bearing on one's own choice of action when that action must be chosen before one can *monitor* the actions of those others"); Rousseau et al., *supra* note 14, at 395.

subdues the pain of certain mortality (and sends it back into the subconscious). Mortality is, thus, the antithesis of trust. Upon death, everything falls apart. The cohesion and stability provided by the process of trusting (as discussed above)[364] disappear in an instant. The cohesion of life (*i.e.*, the human being as a biological, non-interactive system) and the stability of life (*i.e.*, the human as a social, interactive being) both permanently end.[365] Trust is the sedative that gives us a (false) sense[366] of holding ourselves together, of being cohesive, stable, and firm so that we do not feel paralyzed[367] and are able to take "rational action in the present."[368]

d. *Expectations, Information and Confidence*

The expectations and counter-expectations of goodwill which are built into a trust relationship and exchanged by the trusting parties must be well-grounded and embedded in the factual and situational reality of the substance of trusting. Each trusting party will need to signal *and* receive minimum sets of expectations and counter-expectations of trustfulness and trustworthiness with regard to future goodwill of other and self in order to *take the leap into the unknown*[369] which is at the heart of trusting. Unless it were to occur blindly (in which situation we would call the trust extended "blind"[370] and irrational[371]), such a leap will only occur—under normal

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[364]*See supra* notes 273-80 and accompanying text.

[365]*See supra* note 351 and accompanying text.

[366]ANDREW J. WEIGERT, SOCIOLOGY OF EVERYDAY LIFE 82 (1981) ("The trust which undergirds our everyday lives is a pure social construction which answers to our need for security by seeming to be a fact when it is always a projected assumption."). In this regard, one may also argue that trusting is always neurotic because it is driven by a need for security (*i.e.*, the absence of harm from certain mortality) which is permanently unattainable and its unattainability is known *in toto*.

[367]*See* Luhmann, *supra* note 19, at 4 (stating that the only alternatives to trusting would be "chaos and paralyzing fear").

[368]Lewis & Weigert, *supra* note 13, at 968 ("If all possible future events were accorded equal probability, the future would appear with such enormous complexity as to preclude rational action in the present.").

[369]*See* Child, *Fundamental Bond*, *supra* note 1, at 276 ("[T]rust involves something like a leap of faith over and above any basis that we have for certainty."); Dean, *supra* note 11, at 465 ("Trust is a matter of acting on imperfect information."); Lewis & Weigert, *supra* note 13, at 970 ("The cognitive element in trust is characterized by a cognitive 'leap' beyond the expectations that reason and experience alone would warrant—they simply serve as the platform from which the leap is made.").

[370]Blind trust is not to be confused with unconscious trust, *i.e.* trust that remains unconscious to both parties (for example, two drivers on a road going in opposite directions; each driver trusts that the other will follow—under normal circumstances—basic traffic rules that regulate which side of the road to use). Unconscious trust is real trust in that it is based on (some) rational (though not conscious and openly communicated) expectations. Blind trust has no rational footing—it is based on a neurotic expectation horizon. *See* Dasgupta, *supra* note 1, at 50-51 ("[W]e

circumstances[372]—once a party has gathered, received and communicated sufficient levels of information[373] about the goodwill of other and self[374] so that she has developed a basis for trusting others and will feel sufficiently confident about the occurrence (or non-occurrence) of certain future contingencies which the process of trusting and its resultant cooperative activity will manage to enable, if not manage to control.[375]

2. The Trust Exchange—*Take 2*

Having discussed the basic definitional elements of the substance of trusting, it is now possible to explain the interdependency of trust parties[376] and the exchange of trusting premises—as far as the *substance* of trusting is concerned—in three different kinds or levels of substantive reciprocities of trusting. Figure 3 below provides an overview in this regard.

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like to distinguish 'trusting someone' from 'trusting someone blindly', and think the latter to be ill-advised."); Dent, *supra* note 179, at 50 ("To some, trust excludes all calculation; it is what is commonly called blind trust."); Gambetta, *supra* note 30, at 218; *see also* Lewis & Weigert, *supra* note 13, at 972; Luhmann, *supra* note 19, at 81 ("Love and hate make one blind.").

[371] *Cf.* Child, *Fundamental Bond*, *supra* note 1, at 276 ("To trust blindly would be extremely naive and is not a prescription for survival in business."); Hardin, *supra* note 215, at 623; Yamagishi et al., *supra* note 171, at 190 ("Being highly trustful, expecting benign treatment from 'strangers,' in such an environment makes a person unrealistically optimistic."). Irrational trust could also be termed "faith" in its strictest sense. *Cf.* Lewis & Weigert, *supra* note 13, at 972 ("Taken to extremes, if *all* cognitive content were removed from emotional trust, we would be left with blind faith or fixed hope, the true believer or the pious faithful."); Siebecker, *supra* note 11, at 151 ("While encapsulated trust may indeed depend on rational expectations of a certain sort, nothing beyond rational expectation (such as blind hope, belief in God, etc.) can sustain trust.").

[372] There can often be situations where reaching confidence will not be possible, given the restrictions of time, space and the human capacity to sort and process information. In those situations, the leap can still happen if the trusting party calculates that the benefits of trusting outweigh the cost of the current status quo ex ante trusting. For example, I will not be confident that my 18-year-old son could single-handedly carry me down the stairs and out of a second-floor apartment, but if the apartment were on fire and I cannot remove myself from the apartment on my own (since, for example, I am injured), I would have relatively more confidence in letting him try to carry me out (and would have confidence that he would try his best in order to succeed at it) compared to my confidence (or lack thereof) that without trusting him I could still manage to remain safe in the apartment.

[373] *Cf.* TODEVA, *supra* note 1, at 89 ("Communication and exchange of information are an intrinsic part of a dyadic relationship and take place between already connected actors.").

[374] *Cf.* Hardin, *supra* note 215, at 623 ("Whether I should trust you, distrust you, or be neutral is typically a matter of prudence.").

[375] *See* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1767 ("[P]sychologists and sociologists posit that trust is a generalized expectancy or belief about others' behavior formed on the basis of accumulated experience.").

[376] *Cf.* Rousseau et al., *supra* note 14, at 395 (explaining that "interdependence" is the idea that "the interests of one party cannot be achieved without reliance upon another.").

On a first level of substantive reciprocity, the substance of trusting involves a reciprocal, almost entirely symmetrical exchange of goodwill between the trusting parties. Each party to a trust relationship exposes itself to vulnerabilities—both in-trusting and pre-trusting vulnerabilities as discussed above—and may, accordingly, be harmed because of the ex-post opportunistic behavior of the other party.[377] The entrusting party, ceding discretionary power to the entrusted party, may become injured because the entrusted party could abuse the discretionary power over the object or matter entrusted (*i.e.*, *C*) by the entrusting party.[378] But, in addition and as discussed in the procedural reciprocities involved in the process of trusting above, each party—entrusting and entrusted—may be injured during the process of trusting because the other party is not meeting the pre-trusting expectations and counter-expectations of the first party whose expectations became part of the trusting relationship.[379]

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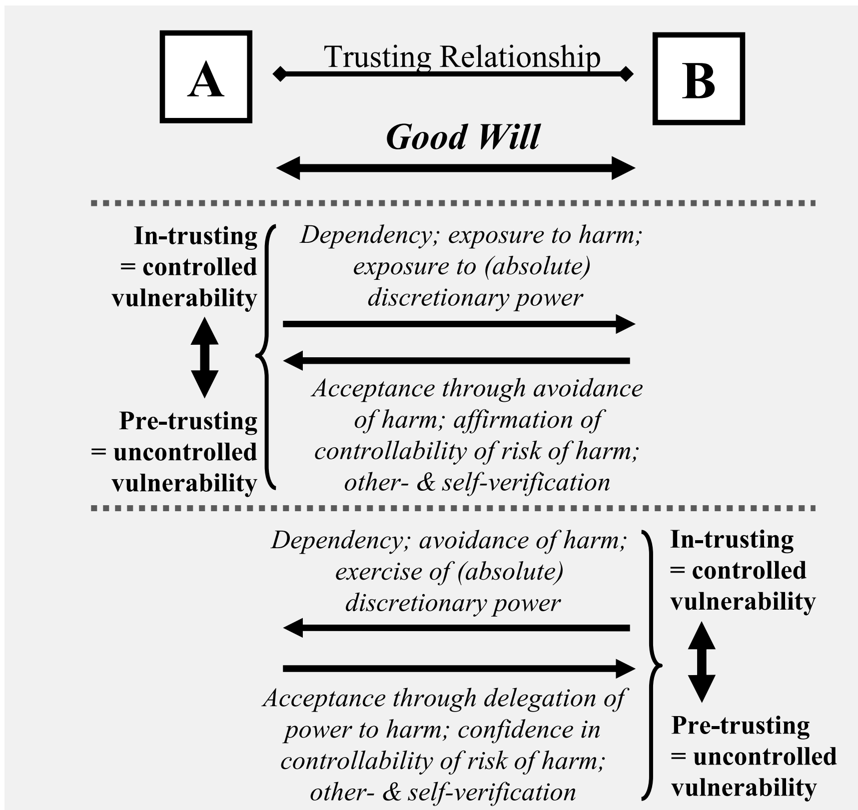
[377] *See supra* Part III.B.1.c.
[378] *Id.*
[379] *See supra* notes 241-43 and accompanying text.

Figure 3

The Substantive Reciprocities of Trusting



Each party's trustfulness and trustworthiness is at risk. Each party's reputation[380] as a trustful, trustworthy and trusting party is at risk.[381] Each party's belief and personal investment in trust—that one, in general, can trust trust and that trust works—is at risk.[382] All of those in-trusting vulnerabilities (*i.e.*, those created by engaging in a particular process of

[380]Dasgupta, *supra* note 1, at 53 ("[T]rust is based on *reputation* and that reputation has ultimately to be acquired through behaviour over time in well-understood circumstances . . . .").

[381]For example, each party—post-trusting—could make misrepresentations to others about the quality of the other party's trustworthiness/trustfulness, about the success of their trusting relationship (or lack thereof), and about the reasons for such success (or lack thereof). *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1750 (explaining the role of reputation).

[382]*See supra* note 380 and accompanying text.

trusting) are put on the line by each party to the trusting relationship in perfect (reciprocal) symmetry with each other and independent of whether the party is entrusted or entrusting.[383] As a result, each party to a consummated trusting relationship extends goodwill to the other party as part of the substance of trusting.[384]

On the second level of substantive reciprocities involved in the substance of trusting, each party will give and receive "self-relevant [and other-relevant] meaning:"[385] *A*—assuming here to be the entrusting party (but the same applies vice versa to *B* as the entrusted party) creates its own dependency and in-trusting vulnerability by exposing itself to potential harm through its voluntary grant of, and resultant exposure to, (often absolute) discretionary power to *B* and *B*'s subsequent (ab-)use of such power.[386] As a substantive reciprocity on this second level, assuming that the trust relationship will be consummated between *A* and *B* successfully, *A* must receive something in return for *B*'s receipt of *A*'s trust. That something—the "meaning" part[387]—begins with *B* accepting *A* as another human being whom *B* is willing to interact with, even to the extent that such acceptance involves assumed responsibility to exercise discretionary power for the benefit of, or the avoidance of harm to, *A*'s interest. *B* is essentially affirming and representing to *A* that *A* and *A*'s interest are important (enough) for *B* to care about and to go out of *B*'s way in order to benefit, or to avoid harm to, them.[388] Furthermore—and most importantly—*B* is also affirming to *A* that it is possible to control the risk of harm—even if (or particularly because) one gives absolute power of discretion to another human being.[389] If a person trusts carefully, others will verify to her and, at the same time, she will self-verify to herself that trust works, that it is a good thing to trust, that her

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[383]Because, as has been demonstrated above, each is both—trusting and trusted—as part of the reciprocal *process* of trusting. *See supra* Part III.A.1.

[384]*See supra* III.B.1.c.

[385]*See* Burke & Stets, *supra* note 173, at 349.

[386]*See* Baier, *supra* note 19, at 240 (mentioning the "voluntarist . . . character" of trust); Galston, *supra* note 1, at 130; Stout, *Mythical Benefits*, *supra* note 32, at 801.

[387]*See* Burke & Stets, *supra* note 173, at 349.

[388]*See* Hardin, *supra* note 215, at 623; Lawrence E. Mitchell, *Trust and the Overlapping Consensus*, 94 COLUM. L. REV. 1918, 1924 (1994) ("In order to sustain trust in the face of . . . vulnerabilities there must be some basis for believing that the trusted party understands and accepts as legitimate the trusting party's interests or goals.").

[389]*Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1785 ("[I]f one assumes that the contracting parties are purely selfish, trying to control opportunistic behavior by asking individuals to adopt an other-regarding preference function makes about as much sense as trying to change the dietary habits of wolves by telling them to like vegetables instead of meat. Yet the empirical evidence on trust . . . demonstrates that people behave as if they do change preferences—and they do so on a regular and predictable basis.").

interests are important because others care about them, and that she is important enough to be cared about—by both others and herself.[390] It is good[391] to be trusting because others are trustworthy and she will be better off being trustful. It is equally good to be a trusted person who can be trusted. Being good in the way one *acts* (and, if acting genuinely, in the way one *is*), means that one does not have to change as a person.[392] Not having to change as a person is *prima facie* good because it is often painfully difficult to genuinely change oneself.[393]

As a mirror-image to this *A*-focused view of the second-level substantive reciprocity of trusting, *B* likewise creates its personal dependency and in-trusting vulnerability by exposing itself to the commitment to, and exercise of, absolute discretionary power and the avoidance of harm to *A*'s interest.[394] Even with the best intentions, *B*'s exercise of discretionary power might not bring about the expected result for *A*'s interest and may even hurt *A*'s interest. In this situation, *B* has not done anything "wrong" (*i.e.*, has not "failed" *A*) but has committed and exposed itself so that *A* may still blame *B* for the reduced benefit or even injury to *A*'s interest. Even if *B* exercised discretionary power perfectly under the circumstances and achieved the best possible result for *A*'s interest, information about both of these facts might be scarce[395] (even to *A and B*), and *A* may (knowingly or unknowingly) hurt *B*'s reputation as a trustworthy party by disseminating incorrect information to others about *A*'s disappointment in *B* and the lack of *B*'s (apparent) trustworthiness.[396] Thus, *B* voluntarily assumes the responsibility to *A* which comes with discretionary authority *and* exposes himself to the vulnerability of being blamed later on (incorrectly) for non-beneficial outcomes. Thus, exercising absolute power in order to benefit, or to avoid harm to, *A*'s interest can be a tall order.

Similarly to *A*, *B* must receive some beneficial self- and other-relevant "meaning" in return for making himself responsible for beneficial outcomes

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[390] *Cf. id.* at 1750 (describing "internalized trust").

[391] Or "efficient." *Cf. id.* at 1753 ("Social scientists have long argued that evolution can favor the development of a capacity for altruism in social organisms such as *homo sapiens*.").

[392] *Cf. id.* at 1785 (describing how people are not "purely selfish").

[393] *Cf.* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1785; Burke & Stets, *supra* note 173, at 349 ("People feel efficacious and good about themselves when they are able to verify themselves.").

[394] *See supra* note 388 and accompanying text.

[395] *Cf.* TODEVA, *supra* note 1, at 89 (stating the importance of "[c]ommunication and exchange of information").

[396] *Cf.* Reich-Graefe, *supra* note 4, at 516-17 (stating that trusting parties "neither like to be shamed nor framed.").

to *A*'s interest and for shouldering *A*'s trust.[397] That meaning again begins with *A* accepting *B* as another human being whom *A* is willing to interact with by delegating discretionary power of benefit and harm. *A* is now affirming and representing to *B* that *B* and *B*'s qualities as a human being (including, of course, trustworthiness) are important enough and sufficiently well developed within *B* for *A* to put *B* in charge—to some extent, at least—of *A*'s destiny and well-being notwithstanding (or particularly because of) *B*'s power to harm *A*.[398] Similarly, *A* affirms to *B* that it is possible to be confident in the controllability of the risk of harm by delegating discretionary power to the "right" other human being(s). Again, if a person does so carefully, others will verify that trust works, that it is a (now common) good thing to be trusted, that the person's qualities are important to others, and that the person herself is important enough to be cared about by other and herself.[399] It is good to be trusted because others are trustful and one will be better off by being trustworthy. To be trusted is good and to trust others' trustfulness is good. As a result, *A* and *B*—in a single self-confirming, self-verifying,[400] self-fulfilling and self-strengthening exercise of trusting—have now also produced a *common good*[401] and, thus, a modicum of "meta-trust," that is "trust in trust-involving relationships and forms of cooperation."[402]

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[397]Which may often be more of a burden than a gift. *See* Mitchell, *Being Trusted*, *supra* note 11, at 599 ("[T]o be told that we are trustworthy demands that we behave at a level that reflects that gift."); Reich-Graefe, *supra* note 4, at 516 (asking whether trust "is is indeed a 'gift' or whether it is rather a curse"). *See also* Baier, *supra* note 19, at 235 ("[T]here is such a thing . . . as unwanted trust, as forced receipt of trust."); Jones, *supra* note 166, at 9 ("We do not always welcome trust. Sometimes someone's trust in us can feel coercive.").

[398]*Cf.* Baier, *supra* note 19, at 235 ("Where one depends on another's good will, one is necessarily vulnerable to the limits of that good will. One leaves others an opportunity to harm one when one trusts, and also shows one's confidence that they will not take it. Reasonable trust will require good grounds for such confidence in another's good will, or at least the absence of good grounds for expecting their ill will or indifference."). *B*'s delegated power to harm *A* makes *A*'s acceptance of *B* more meaningful. If *A* would not accept *B*, *A* would not delegate power to *B* in the first place.

[399]*See supra* note 390 and accompanying text.

[400]*Cf.* Burke & Stets, *supra* note 173, at 349 ("In self-verification, individuals seek to *confirm* their self-views, often by looking at the responses and views of others. In this way, self-verification and self-confirmation are the same process." (citations omitted)).

[401]*Cf.* Mitchell, *supra* note 388, at 1924.

[402]Baier, *Trusting*, *supra* note 166, at 137; *see also* ERIK H. ERICKSON, CHILDHOOD AND SOCIETY 247 (35th Anniversary Ed., 1963) ("basic trust"); Becker, *supra* note 167, at 43 (presenting "the importance of . . . a sense of security about other people's benevolence, conscientiousness, and reciprocity"); Becker, *supra* note 167 at 44 ("[A] particular form of noncognitive trust . . . ought to be of central interest to political philosophers."); Yamagishi et al., *supra* note 171, at 170 (describing the theory of "general trust" (*i.e.*, "trust in others in general"); Yamagishi et al., *supra* note 171, at 171-72, 189-90 (characterizing "general trust . . . as an emancipator of people from the confines of

Finally, on the third level of reciprocities involved in the substance of trusting, each of *A* and *B* exchange within each other—in complete symmetry and harmony and as a result of a successful consummation of trust and of the two prior levels of substantive reciprocities—uncontrollable *pre-trusting* vulnerabilities (*i.e.*, those that pre-exist their trust relationship within each of them) with controllable in-trusting vulnerabilities (*i.e.*, those created by them pursuant to the trust relationship itself). As discussed on the second level of substantive reciprocities, each party affirms to the other the controllability of the risk of future harm as part of the substance of trusting. In other words, the exchange of goodwill at the heart of the substance of trusting *reduces uncertainty-bearing* for each party engaged in trusting with regard to the future.[403] Each party exchanges an absolute, uncontrollable, permanent, non-created, and entirely diffuse pre-trusting vulnerability (namely, the absolute *certainty* of its mortality combined with the absolute Knightian *uncertainty* of the time, place and circumstances of its ultimate death[404]) with a relative, controllable, limited, self-created, and very concrete in-trusting vulnerability (transforming any *uncertainty* about such vulnerability materializing into a quantifiable, perhaps only minimally quantifiable, and voluntarily accepted *risk*).

Trusting, therefore, is an exercise of controlling absolute pre-trusting vulnerability through creating relative in-trusting vulnerability. Trusting constitutes the incremental metamorphosis and reduction of Knightian uncertainty into measurable and calculated risks.[405] The trust exercise exchanges one set of (potentially overwhelmingly large[406]) vulnerabilities with another, smaller set, thereby exchanging the risk of looming mortality with much smaller, non-traumatic, and voluntarily self-imposed risks of potential harm (which risks are, thus, controllable *and* survivable even when they should materialize). Trusting can therefore be described as a controlled gamble (or bet, or hedge)—a limited-downside-probability leap into the *relative* unknown which comes with mostly upside probability.[407] And that

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safe but closed relationships").

All individual accounts of common-good meta-trust can be seen as contributory to, and can be aggregated in, "*social trust*," a "*public good*." *See* Colombo, *supra* note 11, at 845; Ide & Yarn, *supra* note 11, at 1120, 1123-24.

403 *Cf.* Child, *Fundamental Bond*, *supra* note 1, at 276; Dunn, *supra* note 167, at 73 ("Trust . . . is essentially concerned with coping with uncertainty over time . . . .").

404 *See supra* notes 203-06 and accompanying text.

405 *Cf.* Burke & Stets, *supra* note 173, at 349 ("[T]rust [is] . . . more than a rational expectation and calculation; it involves social and emotional bases as well."); Cook et al., *supra* note 2, at 121 ("We define trust building as the process through which social interaction opportunities involving risk are transformed into trust relations . . . .").

406 *Cf.* Luhmann, *supra* note 171, at 97 ("[Trust] presupposes a situation of risk.").

407 *See* Gambetta, *supra* note 30, at 234 ("Trust, even if *always* misplaced, can never do

upside probability does not even have to include any net benefit to any trust party's interest. Both parties are immediately better off when trust works, even if the actual net value of their instance of trusting and of cooperating is neutral. This is because each party reduces its uncertainty-bearing in regards to the future and affirms and verifies the (ultimately incorrect) outlook of the other party—as well as self-affirms and self-verifies its symmetrical outlook—that Knightian uncertainty is *escapable*, at least, within small increments or measures of lived trust.[408] In most general terms, it can therefore be said that engaging in trust works as a strategic[409] solution to the existential dilemma of human mortality and the resultant meaning of life. Neither party is self-sufficient in this regard.[410] The verification of self and other which accrues to each party of a successful trust relationship can only happen *through* the other party's counter-verification of self and other.[411] Each party's interest in trusting, in the fulfillment of trusting, and in the achievement of the payoffs of trusting, logically "encapsulates" the other party's reciprocal and symmetrical interest in the same.[412] Trust, therefore, involves the codependent validation of encapsulated self-interest. Trust parties simultaneously and symmetrically validate self and other internally and externally because they are never able to do so individually and independently of each other. The benefits (if not, the virtues) of trusting are embedded in the logical symbiosis of other and self.

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worse than [sustained distrust], and the expectation that it might do at least marginally better is therefore plausible.").

[408]*See supra* note 257.

[409]Dunn, *supra* note 167, at 74 ("[T]rust is ineluctably strategic, however blearily its adopter may conceive the circumstances in which he or she comes to adopt it.").

[410]*See* Child, *Fundamental Bond*, *supra* note 1, at 276 ("[T]rust is a characteristic of interpersonal relationships . . . ."); Lewis & Weigert, *supra* note 13, at 968 ("From a sociological perspective, trust must be conceived as a property of *collective* units . . . , not of isolated individuals."); Lewis & Weigert, *supra* note 13, at 970 ("Although there are individual differences relevant to the trust factor, the cognitive content of trust is a *collective* cognitive reality that transcends the realm of individual psychology . . . ."); *see also* John Donne, DEVOTIONS UPON EMERGENT OCCASIONS 108 (1624) ("No man is an island, entire of itself; every man is a piece of the continent, a part of the main.").

[411]*See supra* note 400 and accompanying text.

[412]Cook, *Networks, Norms, and Trust*, *supra* note 173, at 6; Hardin, *Distrust*, *supra* note 167, at 496-97; Hardin, *supra* note 215, at 624; Charles Tilly, Book Review, 112 AM. J. SOC. 1293, 1293 (2007) (reviewing KAREN COOK ET AL., COOPERATION WITHOUT TRUST? (2007)). For a discussion of "encapsulated trust," *see* Siebecker, *supra* note 11, at 148-58.

3. Payoffs from the Substance of Trusting

Apart from situations where trusting is absolutely necessary for purposes of subsistence and survival, no one is ever forced to trust.[413] Thus, the question of payoffs from the substance of trusting discussed prior can be rephrased into a much simpler, but also much more potent question: "*Why trust?*" Why accept vulnerability? Are there any further, maybe even more fundamental, quid pro quos—and, thus, "*positive externalities*" (*i.e.*, arising not immediately within but as a secondary product of the trusting relationship)[414]—for one's exposure to in-trusting vulnerability? Arguably, a general answer to this question is not only an affirmative one but, quantitatively speaking; the amount and range of possible specific answers to such question are rather immense and enormously varied. Accordingly, the following discussion is only meant as a first-impression, and thus impressionistic cross section and selection of three specific answers that immediately seem to come to mind (at least, given a research trajectory that arrived at the analysis of the mechanics of trusting by starting with an outline of the theoretical shortcomings of corporate governance research with regard to properly modeling board behavior).

a. *Affinal Reciprocity, Bonding, and Group Identity*

For trusting parties, the symmetrically shared and symbiotic experience of trusting generates its own *common identity* (even if only as *trustful* and *trustworthy* parties after successfully consummating a single one-shot trusting relationship). Trust (re-)affirms to trusting parties that they (co-dependently) create and distribute (*i.e.*, share) a common good—*viz.*, the successful trusting relationship itself as well as all of its immediate internalized payoffs discussed above. Inextricably, the trusting parties therefore also create and distribute the maximized wealth which is accruing to each of them because of their success at (past) trusting and success in (present) trusting. This commonality of both their interaction and resultant identity reciprocally increases affinity for each other[415]—meaning that the

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[413]*See* Lewis & Weigert, *supra* note 13, at 968 ("We would not have to accept [the] risk [created by trusting] if there were some functional alternative to trust."); Mitchell, *Fairness and Trust*, *supra* note 4, at 479 ("[T]rust at some level is not a matter of choice; to live in society, we require some trust."); *see also* Hardin, *supra* note 215, at 624 ("If trust turns on expected incentives of others, then trust is in a cognitive category with knowledge. I do not choose to trust. Rather, once I have relevant knowledge, that knowledge constitutes my trust or distrust.").

[414]*See* Colombo, *supra* note 11, at 845 ("[T]here are positive externalities to trust.").

[415]*Cf.* Siebecker, *supra* note 11, at 147.

(individualistic) *A*-centric and *B*-centric mirror-image views of the substance of trusting discussed above are now transformed from mirror-images of each other to congruent, and thus exact projections of each other (at least, with regard to the limited common identity of being trustworthy and trustful individuals).[416] The individual (and individualizing) differences between *A* and *B* disappear, their self- and other-relevant meaning derived from the substance of trusting matches, and they experience an instance and "sense of unity or 'we-ness'."[417]

In other words, *A* and *B* also create—*qua* trusting—a joint, collective, and unitary *participatory identity*.[418] Their cognitive shift from individual focus to "global unity"[419]—based on their interaction of trusting and the joint perception of their similarities—creates more than just a mere *aggregation* (*i.e.*, an aggregate of two trusting individuals). Rather, it creates an additional *body*, *unit*, or *entity*[420] of trusting which is conceptually separable from its constituent (trusting) parts.[421] That entity of trusting—*bonded* together by the trusting experience as well as the resultant belief of its constituents in their *connection* and *attachment* to and with each other—is usually defined by sociologists and social psychologists as the *group*[422] (here—among two trusting parties—in its minimum-member, and thus most nuclear form). Finally, with the establishment of group (id-)entity comes not only (*group-internal*) attachment to the other and some additional measure of commitment to the group, but also a *collective orientation* vis-à-vis the *group-external* world.[423] In this regard, the theory of "groupthink" developed

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[416]A mirror-image is never an exact "match" of the image—in fact, it is its structural opposite. No matter what the spatial or conceptual position of the mirroring device is in relation to the image, the mirror-image is always a (horizontally or vertically) reverse projection of the image rather than a congruent, *i.e.*, exact projection of the image. Think of holding a paper bearing a written word in front of a mirror. One sees the word reflected *backwards* at her.

[417]Burke & Stets, *supra* note 173, at 352; *see also* Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1803 (defining "projection" as "the human tendency to assume others are like oneself").

[418]Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1742 ("[E]xperimenters have found that cooperation in social dilemmas is dramatically enhanced when the experimenter states (or even hints) that the players ought to cooperate, when the players share a sense of group identity, and when the players expect their fellows to behave cooperatively.").

[419]Burke & Stets, *supra* note 143, at 362 (describing "a global unity—a 'we'").

[420]*See* Toshio Yamagishi & Toko Kiyonari, *The Group as the Container of Generalized Reciprocity*, 63 SOC. PSYCHOL. Q. 116, 116 (2000) (discussing how "the essence of the group exists in the perception of its group 'entitativity'").

[421]*See id.*

[422]*See id.* ("The defining feature that makes a group distinct from a simple aggregation is the existence of actual or imaginary interactions."). Corporate theorists would probably use the term "team" instead.

[423]Burke & Stets, *supra* note 173, at 347 ("We suggest that the process of establishing and

in organizational psychology and its interrelation to trust and trusting will require further cautionary attention.[424] In particular, when taking into account—as Burke and Stets posit—that "[t]he greater the trust for others involved in the self-verification context, the greater will be a group orientation."[425]

b. *Sense-Making and Trust as a Psychological Contract*

The development of, and commitment to, (group) identity as part of the bonding/attachment process of trusting functionally addresses an even more fundamental layer of the trusting parties' very existence and psychological well-being (and sanity) in a world of Knightian uncertainty. As Ring and Van de Ven have pointed out, the process of trusting can be viewed as a psychological contract between the parties of a trust relationship that is the result of, as well as made in pursuance to, the process of "*sensemaking*" in an uncertain world.[426] Through the process and transaction of trusting, each party is offered a (vicarious) opportunity to shape, clarify and reinforce (i) its own *personal identity* as it is interacting vis-à-vis and

maintaining self-verification contexts, and the positive self-feelings that result, lead to the development of interpersonal or group cohesiveness in the form of commitment, emotional attachment, and a collective orientation."); *id.* at 348 ("Self-verification leads to positive self-evaluations and positive other-evaluations in the form of dyadic trust, and trust facilitates attachment to the other. This attachment should reveal itself not only in commitment to the other but also in positive feelings for the other and, we anticipate, in a collective orientation to the relationship.").

[424] Groupthink has been described as the dynamic process by which group members unconsciously forgo their respective abilities to make realistic and internally validated individual adaptive decisions for the sake of conformity with, and commitment to, a group mode of thinking and deciding which will then often morph—for purposes of group cohesion and collective orientation—into a group *esprit de corps* and rapport and into what has been described as "homosocial reproduction." *See* ROSABETH MOSS KANTER, MEN AND WOMEN OF THE CORPORATION 63 (1977) (coining the term "homosocial reproduction"); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1238-39 (2003); *see also* Cox & Munsinger, *supra* note 78, at 92 ("When an individual perceives a group, such as his colleagues on the board, as agreeable, not only is he attracted to continued association with the group, but also because of this attraction he conforms his actions to the group's views."); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 797 (2001) ("Invitations to the board are based heavily on matters like compatibility and 'fit.' The work of the board prizes consensus, not conflict.").

[425] Burke & Stets, *supra* note 173, at 353; *see also* Blair & Stout, *Director Accountability*, *supra* note 11, at 440-41 (discussing the dynamic relation between other-regarding behavior and perceptions of group identity); Cox & Munsinger, *supra* note 78, at 99 ("Ingroup bias is generated by the tendency to raise or reinforce one's own self-worth by magnifying differences between a person's ingroup and a threatening outgroup.").

[426] Ring & Van de Ven, *supra* note 60, at 100 ("Psychological contracts, as opposed to most legal contracts, consist of unwritten and largely nonverbalized sets of congruent expectations and assumptions held by transacting parties about each other's prerogatives and obligations.").

with itself (*i.e.*, its self-view of its own internal world—for example, as a trustworthy and trustful person), as well as (ii) its own *social identity* as it is interacting vis-à-vis and within membership-based groups and society (*i.e.*, its view of its outside world and its participation therein—for example, that the world around it is generally trustworthy and trustful).[427] Such opportunity—as consummated simultaneously through the trust relationship—allows each trust party a self-referential appreciation and grounding of its own entire self-worth[428] and being[429] and, thus, provides wholistic understanding and meaning, *a posteriori*, to the way such party constructs its internal (idiosyncratic) and external (participatory) selves.

As an example of the immediate payoffs in this regard, it may be noted that (most likely) everyone likes a trusting party, and in particular, a high trusting party.[430] If, as mentioned earlier, people have an acquired preference and path dependency for living their lives in an all-pervading ambience of trusting and trust, and will prefer to engage in trusting and trust,[431] a high truster will reap a significant amount of reputational gains (and group memberships) in her trusting interactions, be exposed to an almost constant positive feedback loop of self- and other-validation as a "good" person,[432] and, thus, be (self-)constructing—one trust relation at a time—an ever-consolidating identity and worldview in which not only her actions and thoughts, but her entire life, is lived right and therefore, limited as it inevitably is, will (gradually) make overall and lasting sense. In this regard, trust is not only a social reality but also a pervasive and existentially meaningful, if not, critical psychological event and coping mechanism within each trusting party and, thus, crucial in shaping each trust party's individual (moral) destiny.[433]

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[427]In this regard, trust and trusting are immediately linked with, and relevant to, a field of study in psychology research summarized as "social identity theory." *See* Blake E. Ashforth & Fred Mael, *Social Identity Theory and the Organization*, 14 ACAD. MGMT. REV. 20, 20-21 (1989); Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257, 1291-92 (2011).

[428]*See* Cox & Munsinger, *supra* note 78, at 94 ("Through attachment to a group . . . individuals satisfy their needs to validate their self-worth, particularly by the group's feedback.").

[429]*Cf.* Ring & Van de Ven, *supra* note 60, at 100.

[430]Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1765.

[431]*See supra* note 358 and accompanying text.

[432]*See* Burke & Stets, *supra* note 173, at 347-48 (discussing how self-verification leads to further positive self-evaluation and positive other-evaluation—which, of course, will lay even more of a foundation for further trusting to occur as a process perceived to be beneficial in which to engage).

[433]*See* Lewis & Weigert, *supra* note 13, at 967-68.

c. *Flexibility and Low-Transaction Cost Regulation*

The open-textured, "open-ended"[434] concept of trust as a one-size-fits-all-conditions device of human orientation allows cooperative parties access to another "key ingredient of economic success—flexibility."[435] Flexibility is necessary for successful economic cooperation for two reasons: Business relationships, economic climates, and the ever increasing globalization and competitiveness of our national and international economies—they all require economic actors to respond and adjust quickly and efficiently to the ever-more rapid structural changes and the acceleration in technological and organizational metamorphoses of entire industries which come with them.[436] The flexibility and versatility of today's mutual trust in business relationships is crucial in this regard for purposes of ensuring the parties' continued successful adaptation and innovation to the way their commercial activity today may need to be conducted differently tomorrow.[437]

Flexibility, however, is also extremely important because of the shortness of human foresight. Complete contracts (*i.e.*, contracts that include all terms necessary for their future performance as well as cover all possible future contingencies that have a bearing on the parties future performance) simply do not exist.[438] Even if they might be theoretically possible under the very limited and short-term nature and circumstances of a particular commercial undertaking, no commercial party will bear the prohibitive transaction costs of writing a complete contract.[439] The reason behind this is easy to spot: what is understood does not need to be discussed.[440] It would be plain stupid to write a complete contract in the face

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[434]*Id.* at 972.

[435]Galston, *supra* note 1, at 130.

[436]*See id.* at 130-31 ("In contemporary circumstances, global competition requires rapid changes in organizational structure and mission.").

[437]*See* Child, *Fundamental Bond*, *supra* note 1, at 279.

[438]*See* Colombo, *supra* note 11, at 843-44; Ermisch et al., *supra* note 3, at 750; Lewis & Weigert, *supra* note 13, at 980; Ring & Van de Ven, *supra* note 60, at 105 ("Many transactions are never completely formally specified because the informal processes serve as substitutes for formal transaction processes. Frequently, it is impossible for parties to foresee all possible states of nature that might arise in a cooperative [interorganizational relationship]."); Williamson, *supra* note 13, at 458 ("An immediate ramification of bounded rationality is that impossibly complex forms of economic organization (such as complete content-claims contracting) are infeasible.") (footnote omitted).

[439]*See* Ermisch et al., *supra* note 3, at 750.

[440]*Cf.* Child, *Fundamental Bond*, *supra* note 1, at 274 ("Informal understanding, based on trust, often proves to be a more powerful factor [than formal contracts] in determining how the collaboration works out."); Ring & Van de Ven, *supra* note 58, at 100 ("Psychological contracts, as opposed to most legal contracts, consist of unwritten and largely nonverbalized sets of congruent

of a (in terms of transaction costs) vastly cheaper as well as readily and universally available alternative: trust.

Trust will provide meaning to a contractual undertaking where either (express or implied) contracting is absolutely silent, or is either underinclusive or overinclusive. The exchange of expectations and counter-expectations of future (economic) behavior of other and self which lies at the heart of trust will fairly exactly circumscribe the parameters of acceptable behavior at an unforeseen future point in time in the parties' dealings with each other—all without words; without negotiation; without necessarily even the parties' consciousness about the impact of trusting on their respective behavior; sometimes also against the precise and unequivocal written words of the contract (which were not intended to cover such future contingency but cover it incorrectly in the overinclusive plain meaning of the contractual construction); and with an understanding that—if push comes to shove—the concrete, short-term benefits of ex-post opportunism (created by the gap in contract terms) are always better sacrificed[441] on the altar of the supreme efficiency (if not, the virtue) of the Golden Rule[442] and, thus, in support of the more diffuse, long-term benefits accruing from the "joint contractual egotism"[443] of the cooperating parties.[444]

IV. CLOSING SKETCHES AND FUTURE RESEARCH DIRECTIONS

This Article's approach to trust in the realm of corporate governance can be described as a movement back to basics. It meant to break up the phenomenon and mechanics of trusting into component parts whose functionality could, thus, become understood, measured and, ultimately, applied in the *absolute director primacy* context. It is still far too early (and clearly would exceed the space limits of this Article) to discuss in detail the intricate *implications* of the mechanics of trusting on *absolute director*

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expectations and assumptions held by transacting parties about each other's prerogatives and obligations."); Ring & Van de Ven, *supra* note 60, at 105 ("The remaining issues [not covered in legal contracts] become taken-for-granted assumptions in the psychological contracts that parties develop in relation to each other through repeated interactions.").

[441] *See* Basu, *supra* note 152, at 477 (describing how a "'*rationality-limiting norm*' . . . stops us from doing certain things or choosing certain options, irrespective of how much utility that thing or option gives us" and that those certain things are '*simply not done*'"); Dasgupta, *supra* note 1, at 71 ("There are certain things, while feasible, that are 'not done'."); *see also* Lewis & Weigert, *supra* note 13, at 974 ("Personal trust involves an emotional bond between individuals, and the emotional pain that each would experience in the event of betrayal serves as the protective base of trust even where other types of short-term gains could be realized by breaking the trust.").

[442] *See* Barbara A. Noah, *The Role of Race in End-of-Life Care*, 15 J. HEALTH CARE L. & POL'Y 349, 376-77 (2012) (explaining meaning and origin of the Golden Rule).

[443] Epstein, *supra* note 11, at 10.

[444] *See* Child, *Fundamental Bond*, *supra* note 1, at 274.

primacy. Similarly, a thorough analysis of the impact of trust on corporate governance will require an additional examination and discussion of trust as a *virtue* rather than as a *mechanism*. Once recognized as (moral) virtues, trust and trustworthiness become preordained with broad societal approval and institutionalized expectations. They develop into collective and impersonal (even anonymous) manifestations of behavioral expectations as well as mechanisms of mutual behavioral affirmation *and* validation. In doing so, they operate entirely independent, and exist *a priori*, of the individual, inter-personal trust relationship established between two or more human beings (which has been the sole focus of this Article's investigation of the mechanics of trusting). Thus, it remains necessary to further explain *in toto* how trusting works as an institution of *social* ordering before safely engaging in the predictive utility that may be derived from a positive account of trusting both as a mechanism as well as a virtue for purposes of coupling *absolute director primacy* with a generally understood and measurable quantum of director accountability.[445]

That being said, the outlines of certain applications, caveats, and complications may already be worth mentioning here with regard to trust in the context of *absolute director primacy*. For example, it is obvious that trust between firm participants and board directors is structurally more complex as compared to the simple dyadic trust relationship set-up between two individual persons in a face-to-face transaction.[446] Even if we consider a particular corporate board as an aggregation of its individual members[447] and,

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[445]One possible avenue for, and aspect of, this future explanation should be the connection between *trust* and *commitment*. If commitment is seen as the tie that binds an individual to something else (*i.e.*, task, identity, individual, group, organization, or relationship), it will depend on the (relative) strength of the commitment in order to prevent the individual from opportunistically pursuing other self-interests in the face of suboptimal personal returns from the current, "committed-to" structural connection, thus, from exploiting, defecting from and destabilizing such connection. *See, e.g.*, Burke & Stets, *supra* note 173, at 348 (discussing trust and commitment); *cf.* Cook, *Networks, Norms, and Trust*, *supra* note 173, at 7 ("Th[e] potential exchange of favors is sustained by expectations of reciprocation in the future, forming the bedrock of social life. It is in such a context that trustworthiness matters, and the ability to assess who is and who is not a trustworthy potential exchange partner becomes important."); Stout, *Proper Motives*, *supra* note 18, at 23 ("[T]o do a good job on a board an individual needs an 'internal gyroscope'—something that will keep her steady on her course, despite outside pressures to stray.").

[446]*See* Belcher, *supra* note 11, at 161 ("The exchanges of game theory would not normally qualify as fiduciary relationships"); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1777 (warning about "the potential pitfalls of relying on [social dilemma/trust] experiments to predict human behavior in the far more complex environment of the corporation").

[447]*See* Hermalin & Weisbach, *supra* note 76, at 20 (describing studies on boards of directors where "the board is being modeled as a monolithic entity[,]" yet "[i]n reality, a board consists of individuals who are unlikely to share a common agenda on all matters."). Obviously, this is not the case in real life, and there exists an additional trust universe *between* individual board members and

thus, as a single trust party, we still have a large multitude of diverse firm participants with whom such board establishes separate trust relationships in the course of directing the affairs of the company in question.[448] Also, instead of the occurrence of a single, one-shot trust transaction between two parties, the trust relationships established by (or with)[449] the corporation's board of directors are long-term, multi-faceted and recurrent trust transactions in which the dynamic and repetitive stages of trusting—both as to its process and its substance—take on an additional quality and equilibrium that has been left unexamined herein.

Furthermore, many of the board's trust relationships are not the result of any direct and personal interactions of the trusting parties. Rather, they are automatically imposed by the structure that each firm participant's investment takes and almost automatically spring into existence because of such investment. In other words, most investments are tied to pre-existing, firm-specific channels and structures for such types of investments. Therefore, each investment already comes with a pre-existing, ready-made, (mostly) standardized and, thus, (largely) unalterable firm-specific size, quality, fabric, and network of intra-firm trust relationships which typically accompany this type of investment.[450] Firm participants are accordingly limited in their exercise of trusting to the times of investment entry and investment exit as conscious, individual, and personal exercises of trusting.

Finally, there is the additional complication given that no corporation is an island of economic cooperation and of functional trusting in pursuance thereof. For example, shareholders in publicly-held companies will often evidence a type of generic, institutionalized, and diffuse meta-trust which reaches across a wide spectrum of corporate investments and, thus, across a wide spectrum of corporate boards. As such, instead of investing and

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among all members of the board (which universe could be labeled as a realm of "parallel trust" or "in-tandem trust"). *See* Belcher, *supra* note 11, at 164. This realm of intra-board trusting is, of course, a constituent part and feature of "small-group dynamics" and "thick social ties." *See* Tung, *supra* note 11, at 1178-80; *see also* Yamagishi & Cook, *supra* note 216, at 246 (discussing how "network ties may generate bonds of obligation that are more difficult to generate in groups without a system of norms or sanctioning").

[448]*See* Belcher, *supra* note 11, at 164.

[449]To note the obvious, the board's trust relationships with other firm participants will, of course, occur in both directions (*i.e.*, trust being reposed in the directors by particular firm participants as well as the directors themselves reposing trust in particular firm participants). *See* Belcher, *supra* note 11, at 162-64.

[450]In this regard, one could describe such trust relations as "trusting by adhesion" or as "trust of adhesion"/"adhesion trust." In other words, the standardization of pre-existing, firm-specific trust channels and structures provides transaction-cost savings to both trusting parties, and the beneficial nature of those trust channels and structures—because they are implemented and consummated successfully at very high repetition rates—validates their standardization and utility without (much, if any) need for personal trust "negotiation" (*i.e.*, for "negotiated trust").

evidencing *personal trust* in the particular group of individual directors of a particular corporation (*i.e.*, trusting *ad personam*),[451] firm participants will often evidence and invest what can be called "*system trust*" (as a form of social capital) in that any given board will "do the right thing" without the need of personal interaction, communication, or scrutiny (*i.e.*, trusting *ad rem*).[452] This complication then also means that one feels strangely returned to square one in this entire inquiry. It feels as if corporate actors are only operating with and under the influence of ("double-blind")[453] *imitations* of real trust and trustworthiness (at least, as real as analyzed herein), utilizing such normative values as mere *signals* in order to trigger acceptable series of semi-automated behavioral mo(ti)ves of other and self. All of which, in the end, appears to give trust—as a mechanism—a certain automatizing, reductionist, even puppeteering kind of quality.[454]

Given such fundamental differences in the structure and quality of trusting by Berle-Means firm participants in the board context and by two individuals in the archetypical case of trusting involving their face-to-face, personal interaction and communication with each other which has been at the center of attention herein, it must remain a continuing mystery how trust works as an efficient mechanism of corporate governance. "If part of what the truster entrusts to the trusted are discretionary powers, then the truster risks abuse of those and the successful disguise of such abuse."[455] This finding is merely a restatement in different language (*i.e.*, in trust language)

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[451] Ermisch et al., *supra* note 3, at 751-52.

[452] Regarding the differentiation between "personal trust" and "system trust," *see* Lewis & Weigert, *supra* note 13, at 973-74; *see also* Becker, *supra* note 167, at 44 (preferring the term "noncognitive trust" and defining it as "fundamentally a matter of our having trustful attitudes, affects, emotions, or motivational structures that are not focused on specific people, institutions, or groups"). A similar distinction is usually made in organizational psychology between cognitive-based trust (which is based on the knowledge and recognition of the fiduciary's reliability, dependability, and competence) and affect-based trust (which depends on the investment and reciprocation of the fiduciary's genuine care and concern for the welfare of others). *See* Burke & Stets, *supra* note 173, at 361-62; Colombo, *supra* note 11, at 834-38; Jones, *supra* note 166, at 5-6; McAllister, *Affect- and Cognition-Based Trust*, *supra* note 170, at 25-26; Mitchell, *Being Trusted*, *supra* note 11, at 608.

[453] Ermisch et al., *supra* note 3, at 752.

[454] *See* Baier, *supra* note 19, at 253 ("But what is a trust-tied community without justice but a group of mutual blackmailers and exploiters?"); Becker, *supra* note 167, at 61 ("We may be best served by a trustful disposition that survives perpetual disappointment."); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1743 (stating that "[s]ocial 'framing' . . . plays a critical role in determining whether or not individuals choose to trust and be trustworthy"); Blair & Stout, *Behavioral Foundations*, *supra* note 11, at 1796 ("In other words, *fiduciary duty law works through framing, not shaming.*"); Ribstein, *supra* note 4, at 566. For a critical response to "framing" strategies, *see* Reich-Graefe, *supra* note 4, at 516-17 n.261 and accompanying text.

[455] Baier, *supra* note 19, at 239.

of the fundamental dilemma of *absolute director primacy* as well as of its underlying agency cost problem.[456] If trust, indeed, is to be an accountability mechanism, *i.e.*, a behavioral constraint for the solution of this dilemma, we, thus far, have only made partial progress[457] in mapping out the crossroads of trust and corporate governance.

[456] "[E]ncapsulated trust represents a special agency relationship. That agency relationship exists to the extent that we expect those in whom we place our trust to take our interests into account when determining how to act." Siebecker, *supra* note 11, at 149.

[457] And—perhaps—only in the form of a *petitio principii*, *i.e.*, by assuming that trust is (part of) the answer when it rather may only turn out to be (part of) the (broader) question.