THE NEXUS OF CONTRACTS APPROACH TO CORPORATIONS: A COMMENT ON EASTERBROOK AND FISCHEL*

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INTRODUCTION

Critics and advocates agree that a revolution, under the banner "nexus of contracts," has in the last decade swept the legal theory of the corporation. Though the revolution has undoubtedly transformed not only our understanding of the law, but the law itself, the nature and significance of that transformation remain obscure because, in some sense, the revolution has simply replaced one legal metaphor, the trust, with another legal metaphor, the nexus of contracts. Unfortunately, the legal drapery of both trust and contract ill fits the corporate body. Each metaphor distracts in different ways from the intractable problems with which the law must deal.

These remarks suggest how these two metaphors lead us awry or abandon us altogether through ambiguity. Part I suggests that certain weaknesses of the metaphor of trust are apparently resolved or mitigated by the contract metaphor. Part II argues that the contract metaphor also suffers from ambiguity and other problems that limit its usefulness. As Part III suggests, some of these difficulties can be alleviated by a partial return to the metaphor of trust. The revolution in corporate theory does not entirely displace the metaphor of trust with that of contract; it simply permits us to understand the role of trust and its limitations in corporate transactions.

I. THE INADEQUACIES OF THE TRUST METAPHOR

The spirit of the trust metaphor acquires judicial life in the doctrinal elaboration of the fiduciary duties of loyalty and of care imposed upon trustees. The inadequacies of these doctrines in allocating rights, duties, powers and privileges within the corporation derive directly from their spiritual source. The trust metaphor demands at the outset that one identify the corpus of the trust, the trustee and the beneficiary. Unfortunately, judicial practice offers no consistent set of identifications on which to erect a legal theory.

An initial problem arises from the multitude of corporate actors who may play the role of trustee and beneficiary. The same duties of loyalty and care must serve to constrain, at different times and in vari-
ous contexts, managers, directors and majority shareholders. Similarly, though the courts often name the shareholders the beneficiaries of the trust, at times they identify the beneficiary with the corpus of the trust: the assets of the corporation. Unlike contract, which allows much discrimination in allocating entitlements among parties to the agreement, trust does not seem adequately flexible to explain the complex allocation of obligations and privileges among this web of actors.

A more serious problem is that the trust metaphor determines the content of the obligations of the trustee by reference to the interests of the beneficiary. This procedure suffers from at least two defects. First, even if we assume that courts can conclusively identify the beneficiary in any given case, their attempts to define the interests of such beneficiary will often fail in practice. The courts have no accepted method for attributing interests to the corporation in those cases in which it is designated the beneficiary. A similar problem arises in cases involving conflicts of interest among the shareholders.

A comparison to the contract metaphor reveals the second defect. Contract conditions the existence of an obligation on the “agreement” of the parties to the contract and determines the content of that agreement by reference to the interests of those parties. The entitlements flowing from the contract are thus seen to promote the interests of the parties just as the trustee’s obligation is seen to promote the interests of the beneficiary. In the contract case, however, the interests of the parties serve as a primary justification for the obligations; the promotion of those interests constitutes a basic social goal. Serving the interests of the beneficiary of a trust, on the other hand, seems to be an instrumental goal in service of some other, unarticulated social policy. The instrumental nature of the beneficiary’s interests emerges most clearly when we view the corporation as the beneficiary. It would be odd, after all, to see the promotion of the “interests” of a fictitious entity as the fundamental justification of the institution. Even when we identify the shareholders as beneficiary, however, the promotion of the beneficiary’s interest remains instrumental because we require some justification for subordinating the interests of the trustee (and others with interests in the corporation) to those of the shareholder.

From this perspective, the metaphor of contract promises to avoid some of the defects in the metaphor of trust. Indeed, several of the articles in this symposium adopt the strategy of deriving the fiduciary obligations of the trust metaphor from the metaphor of contract.1 However, the metaphor of contract suffers from ambiguities of its own.

II. THE AMBIGUITIES OF THE CONTRACT METAPHOR

Metaphor guides decision by framing the inquiry that a judge undertakes to resolve a dispute. In corporate law, the metaphor of contract directs the judge to the "agreement" among the "parties" involved in the corporation and predisposes the judge to respect that agreement as she would respect the terms of a legally enforceable contract. Complications arise in corporate transactions, however, because the relevant "agreement" is generally unwritten, frequently ambiguous or contradictory and often not an agreement at all. Rather, the nexus of contracts approach constructs an agreement out of the interests of the relevant parties. In this context, the contract metaphor serves to select the rule of construction the judge will adopt. The metaphor offers ambiguous guidance for this task. The rule of construction offered by Judge Easterbrook and Professor Fischel, the primary advocates of the nexus of contracts approach to corporate law, manifests this ambiguity. According to Easterbrook and Fischel, a court ought to imply the "term [that] . . . increase[s] the joint wealth of the participants—that is, . . . the term that the parties would have selected with full information and costless contracting." While Easterbrook and Fischel have offered a concise formulation

2. As Judge Easterbrook and Professor Fischel demonstrate in their persuasive article, metaphor has rhetorical as well as analytic uses. See Easterbrook & Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416 (1989). Their argument for the contract metaphor shifts among three distinct interpretations of "contract," each of which has force in some contexts but which cannot be simultaneously invoked. They sometimes rely on the moral authority that attaches to the consensual decisions of autonomous actors. See id. at 1427-28. At other times, they appeal to the legal authority and concrete rules of the law of contracts. See id. at 1428-29. Finally, they claim the utilitarian virtue of best promoting the interests of the parties to the contract. See id. at 1433.

Each of these interpretations satisfies some analytic or justificatory intuition but those satisfactions may conflict. Autonomy and utility often point in different directions while the specifics of contract doctrine rely on a third set of concerns.

3. Id. The entire passage merits quotation:

If it is possible to demonstrate that the terms chosen by firms are both (a) unpriced and (b) systematically perverse from investors' standards, then it might be possible to justify the prescription of a mandatory term by law. This makes sense, however, only when one is sure that the selected term will increase the joint wealth of the participants—that is, that it is the term that the parties would have selected with full information and costless contracting. But this, too, is a contractual way of looking at the corporation. This formula is the one courts use to fill the gaps in explicit contracts that inevitably arise because it is impossible to cover every contingency. . . . The gap-filling rule will call on courts to duplicate the terms the parties would have selected, in their joint interest, if they had contracted explicitly. It promotes clear thought to understand that the silence or ambiguity in corporate documents itself is a problem of contract, one the parties could solve if they wished and if the costs of negotiating were worthwhile in light of the stakes.

In addition to its instruction to maximize joint wealth, the above passage offers two other, not clearly equivalent, formulations of the rule of construction: "duplicate the terms the parties would have selected, in their joint interest, if they had contracted ex-
of the default rule recommended by the "nexus of contracts" approach, they have not offered a consistent or even desirable one. Their formulation prescribes two distinct interpretive strategies for determining the intentions of the parties. The quoted passage initially asserts that gaps in the agreement should be filled on the assumption that the parties would have chosen the term that maximizes joint wealth. The qualifying phrase with which this passage ends suggests that courts should fill gaps by reference to the agreement the parties would have reached in an ideal contracting situation. However, understanding the parties' intentions as "increasing joint wealth" will not always result in the terms that they would have reached under ideal conditions.

Moreover, the conditions of "full information" and "costless contracting" against which Easterbrook and Fischel define the ideal contract do not adequately reflect the difficulties that plague corporate actors in structuring their relations. The background conditions of ideal contracting should be more responsive to the positions of the parties at the time of contracting. What do they want ex ante? What do they know ex ante? What external factors constrain their ability to draft "ideal" contract clauses?

A. Wealth Maximization vs. Party Intention as a Guide to Construction

The command "maximize joint wealth" corresponds to the command "implement the ideal contract" only under special circumstances. First, joint wealth maximization does not insure that either utility (in some Benthamite sense) or preference satisfaction (in the tradition of neoclassical economics) will be maximized. Even in a commercial setting, one or more of the parties may derive welfare from sources other than wealth. In the corporate context, this divergence between wealth and welfare may appear in conflicts between managers and shareholders. For example, benefits derived by managers from the power they wield or prestige they gain from their positions may correlate more closely with total revenues or employment than rate of return on assets.

Second, even if each party measures her welfare solely in terms of wealth, an interpretive standard based on joint wealth maximization may still prove inferior to the parties'-intention approach. Each party to the contract cares not about joint wealth but about the wealth she receives from the enterprise. Agreement on maximization of joint wealth does not resolve the dispute over how that wealth should be divided among the parties. In the corporate context, agency problems

4. For an intellectual history of ideas of utility from Bentham to the neoclassicists, see generally Cooter & Rappoport, Were the Ordinalists Wrong About Welfare Economics?, 22 J. Econ. Lit. 507 (1984).

5. Agency problems arise when the interests of agents diverge from the interests of principals and when the principals cannot fully monitor the actions of the agents.
may dictate a particular distribution of the wealth-maximizing arrangement in which managers do relatively well. Shareholders will not necessarily prefer this arrangement to one in which joint wealth is less but the shareholders’ portion is greater.

Third, as the economic literature on shareholder unanimity shows, the criterion of joint wealth maximization may not be well defined.6 Self-interested actors, each of whom cares only about money, may disagree over which production plan will maximize profits. Of course, if securities markets are complete enough and thick enough,7 then all shareholders will agree on the ideal plan. In the absence of unanimity, the joint wealth maximization criterion at best loses its appeal; at worst it becomes undefined. The terms of the ideal contract, on the other hand, may still offer an appropriate resolution of the dispute.

Fourth, the two criteria take different attitudes toward “mistakes” of the parties. Joint wealth maximization will ignore any explicit terms in the contract that apparently do not maximize wealth. Construction under an “implement the ideal contract terms” rule, however, will attempt to interpret the contract consistently with these eccentric terms. Phrased differently, a criterion of joint wealth maximization may attend less to the particular interests of the parties (or to their particular projects and beliefs) than an “ideal contract terms” criterion.

B. The Elusive Search for the Ideal Contract

1. Background Conditions for Ideal Contracts: Costless Drafting and Enforcement. — Two different visions of the ideal contract exist. In neoclassical economics, a complete contingent claims contract constitutes the ideal.8 Easterbrook and Fischel, on the other hand, define the ideal contract as one reached under conditions of “full information and costless contracting.”9 These ideals are not equivalent; moreover, the ideal of Easterbrook and Fischel is not unambiguously defined.

Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976), is an early application of the insights of the theory to the problem of corporate governance.


7. A “complete” market is one in which the “spanning” property is sufficient for shareholder unanimity theorems to apply. See, e.g., De Angelo, Competition and Unanimity, 71 Am. Econ. Rev. 18, 22–23 (1981). Basically, spanning requires that the set of securities must be rich enough so that no single security alters an investor’s ability to insure against any specific state (or contingency). “Thickness” refers to the market’s competitiveness.

8. The idea of a complete contingent claims contract developed from the idea of complete contingent commodity markets as set out, for example, in G. Debreu, Theory of Value 98–102 (Cowles Foundation for Research at Yale University Monograph No. 17, 1959). For an example of the use of a complete contingent claims contract as an ideal, see Kornhauser, Reliance, Reputation and Breach of Contract, 26 J.L. & Econ. 691, 695 (1983).

9. Easterbrook & Fischel, supra note 2, at 1433.
A complete contingent claims contract specifies what actions each party should undertake in each possible state of the world. Consider, for example, a forward contract for wheat between a farmer and a miller. In this situation, a complete contingent claims contract would be extremely complex because it would specify the amount of wheat the farmer should deliver and the price the miller should pay for every possible combination of supply and demand conditions. In the corporate context, a complete contingent claims contract between the managers and the shareholders would specify precisely what action each manager should take, and the compensation she would receive, in every possible circumstance. As a guide to interpretation, then, adoption of the complete contingent claims contract as the ideal recommends that the court fill gaps by requiring the actions that the complete contingent claims contract would have required in the state of the world that actually was realized.

The condition of "costless contracting" at first may seem consistent with the ideal of the complete contingent claims contract because the major barrier to realization of that ideal appears to be the cost of elaborating such a complex instrument. According to this view, gaps occur in a contract because the parties found it too costly to specify what was to be done in certain states of the world. The implicit argument is that, with costless contracting, the parties would have adopted the terms of the complete contingent claims contract.

However, failure to contract over a specific contingency may occur even when the costs of drafting the clause are zero. Suppose, for example, that monitoring costs vary with the event to be observed. Let \( E \) be an event that contains two states of the world \( S_1 \) and \( S_2 \). Suppose that, ex ante, the parties know that they will be able to observe \( E \) costlessly but that it will be extremely costly to distinguish \( S_1 \) from \( S_2 \) ex post. A term that covers \( E \) may differ greatly from separate terms that govern each \( S_i \). Though ex post litigation may discover which \( S \), occurred, the optimal contract would not have distinguished between the two states of world.

As an example, consider a corporation engaged in a single line of business. In the future one of its managers may be presented with an opportunity to enter a line of business that exploits the manager's and the corporation's expertise related to the corporation's extant line of production. Under a complete contingent claims contract the allocation of this opportunity between the manager and the corporation (i.e., the shareholders or shareholders and bondholders) might depend on

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10. This example employs the standard terminology of probability theory. The relevant "universe" or "sample space" is simply a set of states of the world. An event is a subset of that universe. Consider, for example, the sample space determined by the experiment "toss a coin twice." There are four states of the world: \( HH, HT, TH, TT \). The event "heads comes up at least once" is \( \{ HH, HT, TH \} \); the event "heads comes up exactly once" is \( \{ TH, HT \} \) and the event "heads does not come up at all" is \( \{ TT \} \).
whether the opportunity was desirable to the corporation in the projected state \((S_1\) or \(S_2)\) of the market. Suppose, for example, that the corporation would only exploit this opportunity if expansion in this direction were more profitable than expansion of its extant line of production into another geographic market.\(^{11}\) Because the information concerning relative profitability is in the custody and control of the managers, the corporation will have difficulty distinguishing favorable and unfavorable states ex post (at the time the opportunity presents itself). Thus, the parties might have preferred ex ante a clause which simply forbade managers the right to exploit "corporate" opportunities.

To Easterbrook and Fischel, this example may simply indicate that the appropriate interpretation of the condition of "costless contracting" requires not only costless drafting but also costless monitoring. But this prescriptive ideal may be undesirable to parties who must contract in the real world. Faced with this unattainable "global costlessness" ideal, parties might consider explicitly forbidding managerial appropriation of corporate opportunities because incurring the drafting costs reduces expected monitoring costs sufficiently.

2. Background Conditions for Ideal Contracts: Full Information. — Finally, consider the full information condition that Easterbrook and Fischel impose in their definition of the ideal contract. Unfortunately, Easterbrook and Fischel do not describe the content of "full information." Does the ideal contract require the same information as the complete contingent claims contract? In this section, I argue that interpreting "full information" as "the information needed to write a complete contingent claims contract" may not offer either a workable or desirable ideal.

What must be known to draft the complete contingent claims contract? First, the states of the world must be common knowledge\(^{12}\) to each party. Second, the preferences of each party must be common knowledge. Third, each party’s beliefs about the likelihood of various states of the world—her probability distribution—must be common knowledge. Fourth, the parties must know, for each state of the world, the consequences of their projected actions. From this information, we can determine how, for each contingency, the parties would wish to allocate the risk and the price at which such allocation should occur.

In actual contracting situations, the parties have less than full information in several senses. In general, each knows that her information is imperfect. In addition, each party knows that the other party

\(^{11}\) The two states of the world then are: \(S_1 = \) geographic expansion more profitable than product line expansion; and \(S_2 = \) product line expansion more profitable than geographic expansion.

\(^{12}\) "Common knowledge" means that each party knows the relevant information, and that each party knows that the other party knows, and that each party knows that the other party knows that she knows, and so on.
also possesses imperfect information. Finally, each party understands that what she does know may differ from what the other party knows. In light of these acknowledged discrepancies, what recommends full information as a defining characteristic of the ideal contract? The parties (or the policymaker) might understandably prefer some background rule based on an alternative conception of the ideal.

To begin, consider the assumption made by Easterbrook and Fischel about the parties' beliefs as to which state of the world will prevail. “Full information” to them seems to imply identical beliefs, but this understanding of “full information” may be criticized. Given the differences in their initial information, the parties are likely to have different prior beliefs about the state of the world before negotiations begin. Even if we assumed, contrary to fact, that during negotiations each party completely revealed her information to the other party, their posterior beliefs, conditioned on the identical set of new information, may still differ.

More importantly, in many instances, society wishes to encourage asymmetric beliefs. Incentives to innovate or to uncover natural resources depend in part on the amount of disclosure the better informed party must make when the contract is formed. It seems counterproductive to imply terms on the basis of equal information in these instances.13

The most problematic information assumption underlying the economic model of contract is the assumption that the parties know every possible state of the world. The law in other contexts often distinguishes between foreseeable and unforeseeable risks. The distinction is not one between high probability and low probability events, or high expected value and low expected value events, but one between imaginable and unimaginable events. At the time of contract, neither party may have contemplated the now-realized state of the world in controversy.14

13. Ian Ayres and Robert Gertner raise a related point. They argue that one might design the default rule to encourage one party to disclose relevant information to another party rather than, in default, to imply the terms the parties would have wanted. See Ayres & Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules (forthcoming 98 Yale L.J. (Oct. 1989)).

14. Examples of “unimagined” events are difficult to construct. The closing of the Suez Canal to shipping in 1956 might offer one instance. The development of junk bonds as an effective device for raising large amounts of capital may constitute a second example. Bond indentures drafted prior to 1980 probably did not contemplate or even imagine this financing device and the consequences it would have for the value of bonds. As this example suggests, the concept of unimaginability is vague; it is difficult to designate a precise moment when creditors should have begun to imagine and understand this institutional innovation.

However, unimaginable events may be more frequent than the junk bond example suggests. Individuals often have difficulty imagining how specific contract terms will apply in diverse factual circumstances. At some point, complexity gives rise to something akin to unimaginability.
The incongruity of defining the ideal in terms of full information emerges most strongly when we realize that the parties may have contemplated the possibility that they lacked imagination. When an unimaginable event occurs, the parties might consider the imposition of the term they would have negotiated had they imagined the event a highly inappropriate resolution of their dispute. Suppose, for example, that the unimagined event is sufficiently disastrous that, had they anticipated it, the parties would not have contracted at all. The full information ideal gives no guidance in such a situation. Rather, some ex post “fair” division of the loss might best mirror the term they would have chosen to resolve disputes arising from the realization of unimagined events. Even if awareness of a contingency would not have prevented contract formation, the parties might favor a “fair” rule of construction rather than the term they would have acceded to had they imagined the contingency. The price terms of a contract, the terms of management compensation, or the interest rate on corporate bonds will reflect all the risks the parties face. Conceivably, parties can more easily “price” a “fair” default rule than one which specifies “optimal” terms they cannot imagine.

Realization of the complexity of the decision problems faced by corporate actors and the impact of this complexity on defining the ideal contract undermines the appeal of a pure contractual approach. In the face of this complexity, some mandatory rules may appear desirable.

III. MANDATORY RULES OF CORPORATE LAW

The normative desirability of mandatory rules of corporate law remains one of the last battlegrounds in the struggle of the contract metaphor to replace the trust metaphor in corporate legal theory. The trust metaphor’s insistence on the central and mandatory status of managerial and directorial fiduciary duties apparently contradicts the emphasis of the contract metaphor on the ability of the parties to design their own arrangements.

Advocates of the nexus of contracts view of corporations have adopted two strategies to domesticate mandatory rules. First, they have argued that mandatory rules neither do nor should prevail in the law. Second, they have attempted to ground mandatory rules in general and fiduciary duties in particular in the contract metaphor itself. Adopting this second strategy, this section argues that the difficulties in defining the appropriate background conditions for the ideal contract themselves suggest a justification for mandatory rules.

16. See Gordon, supra note 1, at 1593-94.
There are two types of mandatory rules. Primary rules restrict the "bargains" that parties can strike from the time of the formation of the corporation. Thus, with a primary mandatory rule, the legislature or the court imposes a specific allocation of certain rights, duties, powers and privileges on the parties to the corporation from its birth to its death. Secondary rules prohibit the parties from modifying certain terms that they initially adopted. Under secondary mandatory rules, the parties themselves identify the specific allocation of rights, duties, powers and privileges that they wish to impose on themselves throughout the life of the corporation. The state simply permits the parties to precommit to this allocation.

The contract metaphor is perfectly compatible with legal rules that permit parties to bind themselves to some terms at the time of formation of the corporate contract. The parties, after all, may foresee future contingencies in which one party will have an incentive to act to the detriment of the other. If such contingencies are numerous, the disadvantaged party will pay less (or require more) to enter the arrangement. For example, if rules restraining managerial behavior are modifiable, the price of new capital will be discounted for the likelihood of such modifications. Ex ante, both parties may prefer to tie the managers' hands, though in some ex post contingencies joint wealth might be increased by permitting modification.17

The precommitment argument evidently is not available to justify primary mandatory rules. The ambiguities inherent in the contract metaphor, however, do suggest a justification for these rules. Curiously, these ambiguities appear most graphically, though not exclusively, in the case of the single primary mandatory rule that the contract metaphor unconsciously utilizes. Easterbrook and Fischel, for example, implicitly assume throughout their discussion that the parties cannot specify the rule of construction that the courts must use to fill "gaps" in corporate arrangements. How can the contract metaphor justify making this rule a primary mandatory rule?

The rationale for this mandatory rule of construction rests, I think, on the difficulties that beset even ideal contractors. Consider, for example, bondholders, stockholders and managers. The bondholders presumably would want to have the bond indenture construed to maximize bondholder wealth or, perhaps, the financial value of the firm. The term that does this will not obviously maximize the equity value of the firm. Equity holders will want to maximize equity value or perhaps the sum of equity value and private value to the managers. Similarly, managers will desire a term of construction that maximizes the firm's value to them. The entire corporate contract consists of two separate contracts: one between bondholders and stockholders, and one be-

17. See Easterbrook & Fischel, supra note 2, at 1420; Gordon, supra note 1, at 1550.
between stockholders and management. Ideally, each contract would offer its own conception of the "purpose" of the corporate enterprise and thus define its own "ideal" rule of construction. As we have seen, however, the purposes of the various parties are seldom consistent, and this inconsistency may prevent coherent interpretation of interlocking terms. Everyone may find it easier to contract against a fixed "background" rule of construction.

More generally, a mandatory term may facilitate the coordination of the multiple contracts that constitute the corporation. For example, bondholders, at the time they draft their indenture, may care about the terms of the stockholder-manager contract and the extent to which those terms are modifiable. If the terms in the charter are unknown or subject to modification, then the indenture must deal with contingencies introduced by this contractual uncertainty. A mandatory term therefore reduces the costs of drafting the indenture.

This argument does not on its face distinguish among contract clauses. Any unfixed or modifiable term may change in the future and affect the prospects of the bondholder's recovery of interest and principal. The bondholder then has an interest that the managerial contract be completely fixed and determined at the time the indenture is signed. Less extreme outcomes, however, may greatly improve the bondholder's position. Some terms, for example, are more central to the bondholder's concerns, specifically, those concerning the fiduciary duties of the directors and officers to the corporation. These duties require loyalty to the pool of assets and profitable projects that constitute the corpus of the trust. It is against these assets that the bondholders (and all other claimants against the corporation) will have recourse. Prohibitions against self-dealing by the managers of the corpus serve to protect all parties simultaneously. A primary mandatory rule that imposes the duties of loyalty and care on managers and directors thus offers a peculiarly attractive background against which the parties can negotiate other particulars of their arrangement.

18. Contract law itself protects third-party beneficiaries of contracts from subsequent modification of the promisor's duties. See E. Farnsworth, Contracts §§ 4.9-.11, at 232-40 (1982). In the corporate context, each third-party beneficiary is party to a contract which itself has a third-party beneficiary. The bondholders, for example, are third-party beneficiaries to the contract between stockholders and managers. The managers also have interests in the contract between stockholders and bondholders.

19. Two complications bear comment. First, one must construe the duty of care cautiously. What would be optimal for one party to the corporation need not be optimal to another. The duty of care will outline the limits to which one interest may be favored over another without dictating a particular action on the part of the managers.

Second, one might ask why fiduciary duties do not attach to each individual, since each of us has contractual obligations to many parties, each of whom relies on the corpus of our assets to secure her claim. In this individual context, however, no separation between ownership and control exists. The ability to divert assets is therefore somewhat limited. Moreover, the duty of loyalty reappears in part in restrictions against fraudulent behavior.
CONCLUSION

These comments have come full circle. The contractual revolution in corporate legal theory does not replace the trust metaphor with a contract metaphor; rather, it allows us to understand the precise role that trust plays in corporate transactions. Unswerving adherence to the contract metaphor leaves both the parties, in constituting their corporation, and the court, in construing the terms of operation, with insuperable decision problems. “Trust” permits the parties to contract more safely and cheaply, but only mandatory “trust” will do. Terms that the parties may later alter do not offer an adequate background against which to contract. Similarly, the parties cannot themselves resolve the coordination problems inherent in drafting multiple sets of contracts by defining the terms of their trust. They require a single set of terms upon which all can rely. Primary mandatory rules meet this basic need of corporate contracting.