
TRUST V. LAW (IN A BOX): DO ORGANIZATIONAL FORMS REALLY MAKE A DIFFERENCE?

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In this contribution to the University of Illinois College of Law's 2013 Larry Ribstein Memorial Symposium, I assess Professor Ribstein's approach to both trust and the "uncorporation." My thesis is that his disciplinary commitment to a transaction cost economics model resulted in an overstatement of the extent to which business association forms matter in the real world. In contrast to Professor Ribstein's view that mandatory law (which includes corporate law) "crowds out" trust (implicitly making unincorporations more amenable to trust), I see the orderliness of modern and abstract business structures (of any kind) as distinct from, yet operating at the same time and in the same space as, the usual gamut, for better or worse, of human emotions. Even if, as a matter of economic theory, unincorporations do a better job than corporations in permitting owners to control manager agency costs, the theory leaves out (for otherwise good reasons inherent in doing any kind of rigorous science) virtues like trust and vices like greed, fear, and panic, all of which seem just as likely to operate in the unincorporate as the corporate setting.

TABLE OF CONTENTS

I.	INTRODUCTION	1796
II.	ASSESSING TRUST, CALCULATION, AND OTHER MOTIVATIONS IN A BOX	1800
III.	THE METAPHOR OF "CROWDING OUT" V. THE METAPHOR OF THE MACHINE	1809
IV.	CONCLUSION	1811

* Associate Professor, Suffolk University Law School. Thanks to Usha Rodrigues, Bill Callison, and Nicholas Georgakopoulos for comments. David Hyman and his colleagues at the University of Illinois College of Law gathered a remarkable group for the Larry Ribstein Memorial Symposium on October 17-18, 2013, and I was flattered and humbled by being included. It is clear to me from both the paper presentations and the touching remembrances of Larry that he would have appreciated the spirit in which I offer this Essay, even if he wholly disagreed with my conclusions.

I. INTRODUCTION

One need not delve far into Larry Ribstein's 2009 masterwork, *The Rise of the Uncorporation*,¹ to appreciate his commitment to a coherent theoretical defense of the proposition that business forms matter. Not surprisingly, the analytical framework he employed was transaction cost economics.² Among other things, this approach to economic analysis assumes economic actors (1) are rational (though boundedly so) and opportunistic, and (2) may choose to self-regulate their relationships through contract.³ He argued that business association forms are special long-term contracts meant to deal rationally with an unknowable and contingent future. Not only do the parties need to set up decision making structures to deal with future events, but those structures also need to embody coherent sets of rules to deal efficiently with them.⁴ Larry was passionate that unincorporations—business forms like partnerships (particularly those with some measure of limited liability) and LLCs—are not only different from the traditional corporate model in this respect but significantly *better*, as they do a better job of letting owners and managers specify in advance the means by which they will control agency costs (i.e., the costs that arise when managers act in their own best interest rather than that of the owners). That strikes me as fairly noncontroversial and within the disciplinary bounds of transaction cost economics.

What I take issue with here is Larry's attempt to go beyond Oliver Williamson's explicit resistance to incorporating something as incommensurable as noncalculative trust into the economic model. Larry was too much a lawyer and therefore too rooted in the real world to think that incommensurable things like trust did not matter. So in his 2001 article, *Law V. Trust*,⁵ Larry went where Williamson declined to tread. He argued that arrangements more situated in private contract than regulation—the distinction he would later make as between the unincorporate form and the traditional corporation—had an impact on trust among the participants in the business venture.⁶ In short, as far as Larry was con-

1. LARRY E. RIBSTEIN, *THE RISE OF THE UNCORPORATION* (2010) [hereinafter RIBSTEIN, *UNCORPORATION*].

2. Describing precisely what writers mean by transaction cost economics can be complex, particularly for those of us who are not economists. Here it means the work of Oliver Williamson and others who created the "New Institutional Economics" and "new economics of organization." This school of economic thought intended to get beyond the neoclassical focus on market level variables of price and output (as to which firms were merely "production factors"). See Oliver E. Williamson, *Transaction Cost Economics: How It Works; Where It Is Headed*, 146 *DE ECONOMIST* 23, 23–24 (1998) [hereinafter Williamson, *Transaction Costs*]. Instead, they sought to theorize about (not just describe) the actual "play of the game" within firms and institutions. *Id.* at 29.

3. Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 *J.L. & ECON.* 453, 458–59 (1993) [hereinafter Williamson, *Calculativeness*]. Transaction cost economics modifies the "hyperrationality" assumption of neo-classical economics by attempting "to describe 'man as he is, acting within the constraints imposed by real institutions.'" *Id.* at 458.

4. RIBSTEIN, *UNCORPORATION*, *supra* note 1, at 21–22.

5. Larry E. Ribstein, *Law V. Trust*, 81 *B.U. L. REV.* 553 (2001) [hereinafter Ribstein, *Trust*].

6. *Id.* at 557–58 n.17 ("This article is generally consistent with Williamson's distinction [between calculative behavior and personal trust], except that it admits a broader potential for trust beyond personal relationships.").

cerned, mandatory regulation, including standard form corporate law, was oil to the water of what Oliver Williamson called “personal trust” or what Larry called “strong-form trust.” That is, regulation cannot produce personal trust; even more importantly, the presence of regulation can “crowd out” otherwise salutary personal trust.⁷

In Larry’s conception, default fiduciary obligations—the kind that seem to embody relationships based in personal trust—would exist only where there has been “contractual delegation of broad power over one’s property.”⁸ Fiduciary duties so conceived would only oblige one to refrain from self-dealing.⁹ As for other duties that might encompass personal trust, they would need to be set forth in a contract, the essence of which would be articulating, before the fact, the terms of a relationship so as to minimize the transaction costs, agency and otherwise, that may arise after the fact.¹⁰ Whatever personal trust may be, it ought to be the law between the parties only if they expressly make it so.¹¹ Hence, if one chooses contract as the means of regulating a relationship, one should not expect legal relief for a failure of personal trust or other personal characteristic unless the parties established a duty relating to such characteristic in the contract. Conversely, if one chooses personal trust as the means of regulating a relationship, one should expect only to have non-legal avenues of recourse. Yet having said all that, Larry concluded that the process of private contracting (as one finds in unincorporated business entities) is still more conducive than the mandatory impositions of the corporate form to the retention of traditional trust in a business relationship—i.e., traditional trust is less likely to be “crowded out” by the increasing complexity of external regulation.¹²

I resist that last move. Taking a page from a physical scientist, Lee Smolin, I want to suggest here—and this is not meant to be denigrating—that a wholly economic approach to understanding the significance of standard business forms is doing social science in a box.¹³ Notwithstanding the algorithms of transaction cost economics as applied in this context, people still operate with human virtues and vices, not the least of which are trust, fear, greed, and panic. Notwithstanding its ambition to

7. *Id.* at 563.

8. Larry E. Ribstein, *Are Partners Fiduciaries?* 2005 U. ILL. L. REV. 209, 212 [hereinafter Ribstein, *Partners*].

9. Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 908 (2011).

10. Ribstein, *Partners*, *supra* note 8, at 212 (“Moreover, the existence of default fiduciary duties depends solely on the structure of the parties’ relationship—that is, on the terms of their express or implied contract—and not on any vulnerability arising other than from this structure.”).

11. *Id.* at 213 (“[A] narrow approach to fiduciary duties inheres in the contractual nature of such duties. Contractibility requires that duties arise from the parties’ deal rather than from the parties’ personal characteristics.”).

12. *See infra* notes 29–33 and accompanying text.

13. LEE SMOLIN, *TIME REBORN: FROM THE CRISIS IN PHYSICS TO THE FUTURE OF THE UNIVERSE* 37–45 (2013). I discuss Smolin’s work at length in another essay being published contemporaneously with this one. Jeffrey M. Lipshaw, *What Is It Like to Be a Beetle? The Timelessness Problem in Gilson’s Value Creation Thesis*, U.C. DAVIS BUS. L.J. (forthcoming 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2296955 (2014) [hereinafter Lipshaw, *Timelessness*].

go beyond the abstractions of the neoclassical theory, transaction cost theory still aspires to scientific precision, and deals with these virtues and vices as well as the unwieldy complexities, paradoxes, and inconsistencies of real world business transactions in the same way that theory in physics deals with the gap between the models and the reality. It stays inside the box and simply ignores them. That was what Williamson did with non-calculative trust, and what Larry tried to overcome while still remaining within the disciplinary boundary.¹⁴

I am less inclined to see the world through the lens of an economic model, so I have a somewhat different way of making sense of law and trust, and how that relates to the importance of business association forms. Larry and I would have agreed that law (at least business association law) is law and trust is trust and they are significantly different creatures. Where I am pretty sure we would have parted company (and do in this regrettably one-sided debate) is in the extent to which economic models and business association forms map onto those motivations that really make a difference in how people interact, whether as partners, limited partners, LLC members, or corporate shareholders. My thesis is that virtues and vices like trust, greed, fear, and panic pretty much span the entirety of human history, but conceptions about business law and economics are relatively modern inventions. There is a certain amount of rational hubris in thinking there was a quantum leap in human evolution when Bentham and Mill first conceived of happiness as measurable by units of utility or when we modern folks started reflecting our abstract conceptions of subjective rights in contracts. Virtues like trust and their counterpart vices—greed, fear, panic—seem to me as likely to kick in after the fact whether we are talking about partnerships, limited partnerships, LLCs, corporations, or—heaven forbid—nonprofits and benefit corporations. The rational and the affective reside in all of us, to a greater or lesser extent, side by side.¹⁵

Larry pulled no punches in telling me when he thought I was wrong, which was frequent. I think he would find some humor in the thesis of my contribution to a symposium in his memory: not that he was wrong, but that he was trying to force trust into a model that really has no way of handling it. In Part II, I suggest Larry's work was in fact a struggle against "law and economics in a box." The modifier "in a box" means

14. The irony is that the New Institutional Economics explicitly undertook to get more granular about the analysis of the institutions that underlie markets. Williamson set forth four levels of economic institutions. "Level 4" constituted the market level issues of resource allocation, price, and output. "Levels 2 and 3" constituted the institutional environment in which firms operate (politics, law, bureaucracy) and the "play of the game" (how firms govern themselves and transact by way of contract). New Institutional Economics concentrated on Levels 2 and 3. Level 1, to which Larry sought to extend the transaction cost analysis, constitutes "often non-calculative," spontaneous informal institutions, customs, traditions, norms, and religions. Williamson, *Transaction Costs*, *supra* note 2, at 26. Williamson notes that "Level 1 is taken as given by most economists," probably because the practices are not economic, *i.e.*, "deliberative choice of a calculative kind is minimally implicated." *Id.* at 27.

15. Thinking about human inclinations in dualities is a pretty common move, whether it is yin and yang, ego and id, the Jewish tradition of *yetzer tov*, the good inclination, and *yetzer hara*, the bad inclination, or Daniel Kahneman's thinking fast and slow.

that the incommensurable parts of business relationships are hard to model; hence, like physicists dealing with their own disciplinary paradoxes and contradictions, one puts them aside to make some theoretical headway. What we will see is that Larry was more in touch with the real world and thus doing his science less in the box than, say, Williamson, but his effort to reconcile law and trust by translating them both into a common denominator of economic jargon simply did not work.¹⁶ Larry was right in thinking trust was important as a factor in business relationships, but it was a mistake to try to measure law and trust on a utilitarian “sliding scale” under which increasing complexity of law and regulation in the commercial arena purportedly “crowds out” trust.

In Part III, I react to the “crowding out” metaphor and propose an alternative—the metaphor of the machine—for thinking about the relationship of, on one hand, the use of economic theory and legal constructs as a means of prediction and control of an unknowable future and, on the other, those aspects of human nature that resist reduction to predictable regularities. Business organizations are complex yet intangible modern systems under which people and property are supposed to operate with something approaching machine-like efficiency. Rules and law, as a subset of rules generally, are the rational machine parts we use in constructing the system. But the system is still populated by human beings whose emotions, urges, desires, greed, and altruism defy reduction to machine-like algorithms. I am not sure exactly what something like “traditional trust” is. Nevertheless, if we (1) focus solely on the machine-like parts of the system or (2) try to analyze trust as though it were a machine part, we are missing something important. At the risk of metaphor overload, those incommensurables are to the science of business association forms as dark matter or dark energy is to the current state of physics.¹⁷ That is, we know something exists, but we cannot account for it in our models. I reconcile the orderliness of the law—the modern machine—and the unpredictability of human nature with a different metaphor about traditional trust as system-regulating liquid. In other words, it is something like trust that keeps either corporations or uncorporations (if not whole economies) from melting down.

16. For a discussion of New Institutional Economics with respect to norms, see Juliet P. Kostritsky, *The Law and Economics of Norms*, 48 TEX. INT'L L.J. 465 (2013), and sources cited therein.

17. If there is metaphor overload, all I can say is “Larry, you started it.” In laying out the fundamental dichotomy between corporations and uncorporations, Larry said this:

If business associations were animals, uncorporations would be cats, multiplying in unseemly fashion, running all over the place, refusing to fall into a mold, and defying regulators’ efforts to bring them to heel. By contrast, corporations would be dogs, slotting comfortably into a particular structure that lends itself to regulation.

RIBSTEIN, UNCORPORATION, *supra* note 1, at 37.

II. ASSESSING TRUST, CALCULATION, AND OTHER MOTIVATIONS IN A BOX

In his recent and provocative book, physicist Lee Smolin coined the phrase “doing physics in a box” to capture how scientists focus on a manageable slice of complex reality for purposes of deriving something universal and timeless.¹⁸ Smolin was not denigrating physics or physicists (he is one, after all), but was trying to articulate the gaps between the mathematical models used to explain the universe on one hand and the reality of the universe being explained on the other.¹⁹ Physics is the science that has made the greatest progress in reducing reality to mathematical models. But the mathematics is not the reality. There is a difference, say, between the idealized curves that describe the orbit of a planet and the reality of the planet’s orbit.²⁰ All physics since Newton (even relativity and quantum mechanics) involve what Smolin calls the Newtonian paradigm.²¹ That means if scientists are to apply mathematics in a meaningful way to a physical system, they need to select only a few variables to study out of the rich reality of the universe.

The same kinds of issues arise when academic lawyers and economists undertake to describe the real world of business transactions.²² Oliver Williamson’s account of trust in commercial relationships, on which Larry partly based his own critique, reflects economics in the Newtonian paradigm.²³ Even if Williamson’s account of human relationships purported to be more capacious than neoclassical theory, it still aspires to *theory*.²⁴ As to trust, he thought what we perceive as such in commercial relationships—for example, shareholders’ trust in corporate management—is “simply calculated risk.”²⁵ Thus “[traditional] trust, if it obtains at all, is reserved for very special relations between family, friends, and lovers.”²⁶ His model deals in deliberative choice based on calculation.

18. SMOLIN, *supra* note 13, at 37–45.

19. *Id.*

20. *Id.* at 7–9.

21. *Id.* at 43–44.

22. See Lipshaw, *Timelessness*, *supra* note 13 (discussing Ronald Gilson’s seminal 1984 Yale Law Journal article on the law and economics of transactional lawyering. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 97 YALE L. J. 239 (1984)). That piece is a more general critique of attempts, like Gilson’s, to justify transactional lawyering as a science.

23. Williamson, *Calculativeness*, *supra* note 3, at 463–66.

24. As I do not seek to displace other economic theories, like neoclassical theory or the “old institutional economics,” I am less concerned than those within the discipline about not having “a theory to beat a theory.” Williamson, *Transaction Costs*, *supra* note 2, at 25. Nor do I aspire here to prediction, what Williamson and I would agree is “the touchstone of scientific knowledge.” *Id.* at 35–36 (quoting NICHOLAS GEORGESCU-ROEGEN, *THE ENTROPY LAW AND ECONOMIC PROCESS* 37 (1971)).

25. Williamson, *Calculativeness*, *supra* note 3, at 463–64.

26. *Id.* at 484. As noted previously, New Institutional Economics (a component of “transaction cost economics”) attempts, as neoclassical economics did not, to take account of non-market norms that influence how economic actors organize and cooperate. Kostriksy, *supra* note 16, at 467–68. Even in this approach, however, the observer only sees a pattern of behavior. People may drive on the right or stop at stop signs because they are consciously obeying the law to avoid sanction or because they are obeying a norm regardless whether the force of government command or sanction lies behind it; without some assessment of their subjective motivations, the observer will not know if it is one or

Trust cannot be so modeled because it is not observable, not measurable, or not capable of being reduced to a mathematical function. In the Newtonian paradigm, the model simply ignores it for the time being.

Williamson really had, at best, only a casual empirical basis for this binary distinction between personal and calculative trust; his decision to exclude trust from the analytical mix had far more to do with setting limits on the discipline so as to keep it coherent.²⁷ As he noted, only a calculative (versus trusting) orientation to commercial relationships promotes “the development of a science of organization.”²⁸ Hence, in the transaction cost model, one must start with the assumption that the actors are rational, and then throttle back slightly to say that rationality is bounded: “economic agents are *‘intendedly’* rational, but only *‘limitedly’* so.”²⁹ There is a kind of infinite regress that the model has to assume but otherwise leave untouched, which is that the boundedly rational actor can view his own rational mind as a scarce resource, and therefore seek ways to economize on it. One way of doing this is “the ‘conscious, deliberate, purposeful’ use of organization.”³⁰ Moreover, one must assume that the actors are opportunistic. That means that at any given moment they may not see their promises in the past (or any other sunk costs for that matter) as bearing on an economizing decision in the present.

The heart of Williamson’s rejection of trust in favor of calculativeness is a vector diagram linking three variables: price, the hazards associated with the exchange, and the safeguards within which the exchange is embedded.³¹ A boundedly rational and opportunistic actor will determine price at any given moment in light of the hazards and safeguards at that moment. Hence, a contemporaneous exchange of price for goods or services is at price p because there is neither risk of future hazard nor need for safeguard against it. An exchange that is not immediate has a

the other. The subjective motivation is what H.L.A. Hart called the internal point of view, and it was critical to his thesis about what constituted law and what did not. H.L.A. HART, *THE CONCEPT OF LAW* 55–60 (1961). I accept Juliet Kostritsky’s working definition of norms as social *institutions* that include “patterns of behavior, impulses, and spontaneous ordering enforceable by non-legal sanctions.” Kostritsky, *supra* note 16, at 471–73. I am less convinced that a subjective affect like personal trust is an “institution” precisely because it is internal and subjective and only observable in the sense that it motivates behavior that could have been motivated otherwise. *Id.* at 469 n.24 and accompanying text. Indeed, one authoritative source defines institutions as:

The rules of the game: the humanly devised constraints that structure human interaction. They are made up of formal constraints (such as rules, laws, constitutions), informal constraints (such as norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics.

Alexandra Benham, *Glossary for New Institutional Economics*, THE RONALD COASE INSTITUTE, <http://www.coase.org/nieglossary.htm> (last visited Mar. 19, 2014). Perhaps that is why Williamson preferred to leave the entire concept of personal trust out of the model. But, in any event, it is clear that whatever trust is, it is not a norm.

27. This is the cheeky part of the Essay where I explain why a Nobel Prize winner kind of got it wrong.

28. Williamson, *Calculativeness*, *supra* note 3, at 485.

29. *Id.* at 458 (quoting Herbert Simon, *Rationality as Product and Process of Thought*, 68 AM. ECON. REV. 1, 12 (1978)).

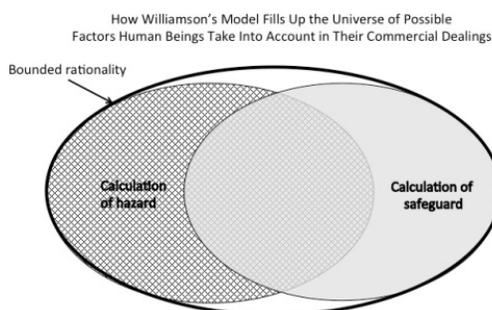
30. *Id.* at 458 (quoting CHESTER BARNARD, *THE FUNCTIONS OF THE EXECUTIVE* (1962)).

31. *Id.* at 461.

hazard greater than zero, and if there is no safeguard, the price p' ought to be higher than p to account for the risk. But if there is a safeguard, then the price ought to be p'' , and p'' ought to be lower than p' but higher than p . Williamson's claim is that this is indeed how economic exchanges ought to be modeled in transaction cost economics.³² The relevant algorithm reflects that (1) price is in part a function of the extent to which the safeguards of future performance mitigate the hazards, (2) weighing safeguards and hazards is a calculative process, and (3) reference to trust (a "diffuse" term with mixed meanings) simply confuses matters.³³

That is the Newtonian paradigm—doing science in a box. The assumptions are neither good nor bad, but in the nature of cabining off a small enough piece of reality to be able to draw universal and meaningful generalizations. Figure 1 is a rough graphic approximation of how I see Williamson's view of the world. The entire universe of motivations is taken up by variants of calculative reasoning—those for which a neoclassical economist is comfortable representing the concept as a letter variable in the formula (as though doing so makes it quantitative rather than qualitative). Here they are the calculation of hazard and the calculation of safeguard, and they fill up the "configuration space" (to use a physics term) of bounded rationality.

FIGURE 1



Economic actors know what the hazard is in any future exchange, and their price reflects the extent of the hazard offset by the safeguards.

In his 2001 article, *Law V. Trust*, and taking his lead from Williamson and others, Larry wrestled with the role of trust in economic transactions, and considered whether law had anything to do with it.³⁴ Implicit in Larry's view that law is simply irrelevant to traditional trust is the idea that where law is, trust is not.³⁵ But he was too pragmatic wholly

32. See *id.* at 466–69.

33. *Id.*

34. See Ribstein, *Trust*, *supra* note 5.

35. See *id.* at 554.

to adopt Williamson's view that it was appropriate simply to write off traditional trust as having no explanatory value in commercial relationships.³⁶ It was clear to him that incommensurable and unconditional personal trust was good, but why? Was there a systematic and theoretically rigorous way of thinking about it? His answer in 2001: putting aside any moral considerations and focusing merely on the economics, trust tends to reduce transaction costs and thus increase total surplus.³⁷ Larry thought most law was irrelevant to "strong form" trust as he defined it: leaving oneself vulnerable to the actions of another, and without resort to external constraint to control or punish the other.³⁸ His primary thesis was that mandatory legal rules—i.e., regulation that supersedes private contract—not only was not trust-producing, but was likely to diminish private actors' inclination to traditional trust.³⁹ His view of privately created legal rules—i.e., contracts—was more ambivalent. While he did not think private law in the form of contracts would produce traditional trust, he thought private law was at least compatible with it because private arrangements were less likely than mandatory law to "crowd out" trust.⁴⁰ This refers to the notion that the more complex the commercial relationship, the more likely the transactions are capable of being assessed by way of the rationality of economics versus incommensurable attributes like trust. In short, extrinsic motivations like monetary reward and regulation "crowd out" noneconomic motivations like benevolence or trust.⁴¹

The "crowding out" metaphor was a hedge. Mandatory law was unlikely, in Larry's view, even to *contribute* to the creation of strong form trust.⁴² Private law was different. He noted the importance of semistrong trust in firms, equating it to Williamson's calculativeness.⁴³ But Larry did not adopt Williamson's view that *any* trust that is meaningful in a commercial relationship is calculative to a greater or lesser extent and therefore not really "trust."⁴⁴ Larry saw traditional trust as having significance in *some* commercial relationships: "although contracts themselves do not create 'trust' [referring to strong form trust] in the sense that the term is used here, legal enforcement of contract is more conducive to the development of trust than are mandatory rules that supersede contract."⁴⁵

Larry's analytic technique was to distinguish "strong-form" trust where there are no external restraints on the person to be trusted from either "semi-strong form" where there are structures for protection of

36. *Id.* at 563–64.

37. *Id.* at 554.

38. *Id.* at 557–58. This would be "personal trust" in Williamson's terminology. I have grouped both under the term "traditional trust."

39. *Id.* at 554–55.

40. *Id.* at 570.

41. *Id.* at 581 (citing BRUNO S. FREY, NOT JUST FOR THE MONEY 7–8 (1997)).

42. *See id.* at 590.

43. Ribstein, *Trust*, *supra* note 5, at 570–71.

44. *See* Williamson, *Calculativeness*, *supra* note 3, at 479 (distinguishing calculativeness from "nearly noncalculative trust").

45. *Id.* at 554 n.3.

the trusting party but they are likely to be inadequate, or “weak form” that is more akin to reliance (*à la* promissory or equitable estoppel) for which there are acknowledged legal remedies.⁴⁶ As to the strong form, he argued that law was irrelevant to the production of any of its variants: trust that arises from (1) predisposition to trust, (2) intimate and personal relationships, (3) social norms, and (4) social capital.⁴⁷ This is what he said in connection with social capital, but it serves to illustrate the general theme:

We may trust others to some extent because our religion teaches us to do so or because the others are in our groups, but not because we know others are coerced into being reliable. Law’s role, at most, is to pick up where social capital leaves off.⁴⁸

Larry thus articulated a sliding scale: the more people were constrained by legal coercion, the more those constraints substituted for “relatively friction-free strong form and semi-strong form trust.”⁴⁹

Private constraints may, however, be compatible with trust. As long as people are not completely constrained by law, there is room for vulnerability and therefore trust. To be sure, detailed contracts, like legal regulation, may “crowd out” trust. However . . . mandatory constraints only exacerbate this problem. Thus, crowding out supports relying on strong form trust rather than contractual constraints, but not replacing private ordering with mandatory rules.⁵⁰

That is to say, even the kind of pre-dispute planning we do in private ordering is “inconsistent with the nature of personal relationships,” and thus “may ‘crowd out’ intrinsic motivations to trust and be trustworthy.”⁵¹

46. *Id.* at 555–57 (relying on a taxonomy articulated in Jay B. Barney & Mark H. Hansen, *Trustworthiness As a Source of Competitive Advantage*, 15 STRAT. MGT. 175, 175 (1994)). This is consistent with the broader thesis in transaction cost economics that sees legal regulation of this kind of trust as “presumptive contract rules” rather than “a distinctive set of absolute duties.” Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 540 (1997).

47. *See* Ribstein, *Trust*, *supra* note 5, at 558–68.

48. *Id.* at 568.

49. *Id.* at 580 (continuing the use of the friction metaphor for transaction costs).

50. *Id.* at 570.

51. *Id.* at 581.

FIGURE 2

How Ribstein's Model Deals with the Overlap of Law and Trust

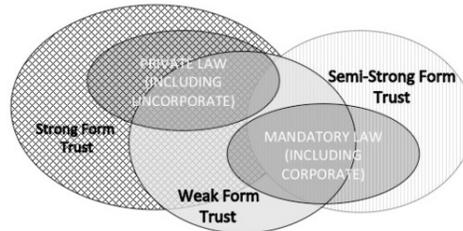


Figure 2 is a graphic rough approximation of how I see Larry's views. Parsing the universe of trust into three groups, Larry sees mandatory law as perhaps consistent with weak or semi-strong form trust, but wholly irrelevant to strong form trust.⁵² This contrasts with private law, which does not wholly crowd out strong form trust. Thus, the theme that carries through to Larry's normative preference for the unincorporation is that private ordering (as in unincorporations) is more likely to leave room for personal relationships, less likely to crowd out traditional trust, to reduce transaction costs (particularly agency costs), and therefore to increase wealth and generally to make the world a better place.

The logic, if we extend the assessment of trust to unincorporations, runs something like this: (1) trust reduces transaction costs, which (2) in the paradigm leads to greater efficiency, and (3) while law is irrelevant to strong form trust, nevertheless (4) organizations governed by private contract (i.e., unincorporations)⁵³ are more likely to reflect more trust and efficiency than those governed by mandatory law (i.e., corporations). A good example would be the unincorporate form adopted by the Blackstone Group when it went public as a limited partnership.⁵⁴ The limited partnership agreement, as permitted by Delaware, wholly disclaims any of the fiduciary obligations as between centralized management and the limited partners that would exist as a matter of mandatory corporate law, were the firm to have used the corporate form.⁵⁵ Effectively, the Blackstone managers are telling the limited partners: "you have to trust us, because you have no legal remedies whatsoever."⁵⁶

52. *See id.* at 590.

53. The hallmark of the unincorporation is its reliance on private contracts versus government regulation. RIBSTEIN, UNINCORPORATION, *supra* note 1, at 6–7.

54. LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, UNINCORPORATED BUSINESS ENTITIES 383–84 (4th ed. 2009).

55. *See id.*

56. *See id.*

This is where our analytical frameworks part ways. The Blackstone offering was wildly successful.⁵⁷ Was it, as Larry seemed to think, because of the parties' use of an unincorporation as a way of voluntarily substituting money for mandatory corporate legal protections against untrustworthiness?⁵⁸ Or was it, as I suspect, because trust, and the legal remedies for breaching it, simply did not enter into the choice whether or not to invest? I am skeptical of the effort to find a common denominator between trust and calculation of either one's utility or one's rights.

I see law, whether in the form of government regulation or private contract, as based in rights and therefore capable of analysis and reduction in a way that something like trust is not.⁵⁹ At the outset, having agreed with Larry that traditional trust has something to do with making oneself vulnerable to another, I resist the overtones of rationality in the use of the phrase "willingness to make oneself vulnerable to another" as though we will to trust, or more directly in Larry's citation to Luhmann's characterization of trust as "a *decision* by one person to give power over his person or property to another in exchange for a return promise."⁶⁰ Indeed, I have resisted his further attempt (*pace* Williamson) to adopt algorithms for trust in the style of neoclassical microeconomics as though by substituting a letter variable for the concept we can immediately make it quantitative rather than qualitative.⁶¹ The critical distinctions are not among the kinds of trust, but between relationships based in traditional trust as simply one kind of human emotion, on one hand, and those based in rights of any kind, public or private, on the other. Suggesting they are mutually exclusive through a metaphor of "crowding out," as though they are physical things capable of being measured at all (much less on the same scale) or incapable of inhabiting the same space strikes me as far fetched.

In some respects I agree more with Williamson's nearly binary taxonomy of personal trust versus "all other," even if I wholly disagree with Williamson's decision to exclude personal trust from the analytical very idea that a subjective and private expectation can be reduced to a "right," whether of natural or positive law, is a modern one.⁶² Rights are normative and timeless conceptions of how the world *should* work; not surprisingly, people began to think about them at the same time they began to develop sophisticated descriptive and timeless conceptions of how

57. *See id.*

58. *Id.* at 384.

59. For the argument that contracts are merely linguistic models of the relationship and not the reality of the relationship itself, see Jeffrey M. Lipshaw, *Metaphors, Models, and Meaning in Contract Law*, 116 PENN ST. L. REV. 987, 996 (2012).

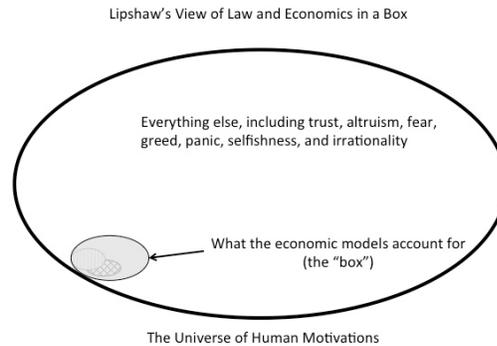
60. Ribstein, *Trust*, *supra* note 5, at 556.

61. Hence, he proffers Luhmann's formula that trust results when the probability adjusted gain from trusting exceeds the probability adjusted loss of not trusting, using the example of leaving a car with a parking attendant. *Id.*

62. I discuss this idea at greater length in the *Value Creation* essay. Lipshaw, *Timelessness*, *supra* note 13 at 12, 19–20.

the world *does* work.⁶³ Happiness, relationships, and mutual expectations have been around forever, but their objectifications as universally applicable concepts like utility and rights (and, as a subset of rights, law) have not.⁶⁴ Figure 3 represents my conception of the universe of motivations, and how the models of law and economics, like either Williamson's or Larry's, relate to them. I may have the proportions off a bit, but they constitute a very small subset.

FIGURE 3



If rights established by mandatory or voluntary law can crowd out trust (or, on the other hand, fear, greed, and panic), it means that something very fundamental about human nature has changed, since the very idea of a “right” has only existed for about six hundred years.⁶⁵ We are more modern than we used to be, but generally we have the same human DNA in 2014 that we had in 1814 or 1614. I resist the idea that we leave our inclinations to traditional trust on the doorstep as we get in the car or on the subway to commute to work, take our seats at the trading desk, or review our personal investment account summaries. We leave ourselves vulnerable to others on a daily if not hourly basis without coming close to a sense of “willingness,” much less a decision, and probably would not walk out the door in the morning if we really thought about the extent to which our lives or livelihoods rest on the actions of others. Every time I drive down US-31, a two lane highway with a 55-mph speed limit more honored in the breach, from Charlevoix to Atwood (something I do almost every day during the Michigan summer), I leave myself vulnerable

63. SMOLIN, *supra* note 13, at 263–64.

In the past, great conceptual steps in physical science have been echoed in social science. Newton's idea of absolute time and space is said to have greatly influenced the political theory of his contemporary, John Locke. The notion that the positions of particles were defined with respect not to each other but to absolute space was mirrored in the notion of rights defined for each citizen with respect to an unchanging absolute background of the principles of justice.

Id.

64. See Lipshaw, *Timelessness*, *supra* note 13, at 13 for a more fulsome development of this idea.

65. See *id.* at 14–15 n.52.

to the oncoming traffic, and it takes something like writing this paragraph even to think about it. I rent a house to a tenant and I know the protections in the lease are at best cold comfort. When I think about his character, I may have reason to panic, but I simply do not. The same fears about my partners, the CEOs and management of the corporations in which I invest, the competence of my investment adviser, and whether my doctor knows what he is doing all reside in the barely conscious background, and from time to time they surface, trust disappears, and I move quickly from comfort to stress to panic. Indeed, on a macro basis, regardless of the calculation that may have accompanied an investment decision, liquidity crises in financial markets are based in panic and fear when this trust disappears, not in calculation.⁶⁶

I do not mean to suggest that we cannot or do not make calculated decisions to trust, but I am less willing than Larry was to think that legal forms into which we decide to organize our business firms have much effect *at all* on this emotive way we go about trusting or not trusting (or, on the other side of the coin, fearing, blaming, or panicking about) either our partners, our LLC managers, or the CEO of the corporation. I accept Larry's dictum that all business associations are means of organizing rationally to deal with the possibility, indeed the certainty, that the future is unknowable, and that everyone is better off having coherently "set up decision making structures to deal with events as they arrive."⁶⁷ The fundamental normative point in *The Rise of the Uncorporation* is that uncorporations, unlike corporations, are creatures of private contract, flexibly respond to what the parties really want, and are not the product of some outside governmental or bureaucratic dictate. As in *Law V. Trust*, the view derives not from moral considerations,⁶⁸ but from Larry's firm belief that the uncorporate form does a better job of reducing agency costs, in this case the agency costs that arise when the interests of a firm's managers are less than fully aligned with those of the firm's equity owners. That is, the flexibility of the uncorporation serves better in the vast majority of cases than "off the shelf" standard form corporate default rules in reducing the costs that occur when passive owners delegate authority either to non-owner managers or to other active owners.⁶⁹

66. Alan Blinder's choices of phrase in describing the events of August 2007 and thereafter are telling. Whether you were French or American, the signal was clear: It was time to panic. ALAN S. BLINDER, *AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD* 90 (2013). "In the narrower, technical view, the financial world was experiencing a *liquidity crisis*—an acute one, to be sure, but still a liquidity crisis. In plain English that meant that frightened investors and institutions wanted to get their hands on more cash than was available." *Id.* at 93. "The accepted central banking solution to liquidity crises] was *lend freely*, against *good collateral*, but at a *penalty rate*. Why? Because the acute shortage of liquidity in a panic can push even solvent institutions over the edge. . . . The disease is highly contagious." *Id.* at 94. "Speculators in panicky markets have been aptly described as a pack of jackals looking to attack the slowest antelope in the herd." *Id.* at 102.

67. RIBSTEIN, *UNCORPORATION*, *supra* note 1, at 21–22.

68. Ribstein, *Trust*, *supra* note 5, at 575.

69. RIBSTEIN, *UNCORPORATION*, *supra* note 1, at 1.

As *The Rise of the Uncorporation* makes clear, Larry viewed mandatory and nonwaivable corporate rules as the same kind of external regulation that he found so uncongenial to the creation of trust in *Law V. Trust*.⁷⁰ My point here is relatively subtle. He may have been right in thinking that unincorporate forms did a better job than the corporate form in managing agency costs. But I do not think it is because, as he suggested in *Law V. Trust*, private contracting of the kind used to govern unincorporations is more compatible with traditional trust than the mandatory rules inherent in the corporate form.⁷¹ The problem, again, is doing science in a box. Our transactions occur in the real world, not some abstract model of it. Looking at trust as a good and trying to measure it with an abstract concept like utility—as though you can measure it as a set off against other transaction costs—confuses the reality of the relationships with the abstract conception. That same problem exists when thinking about business association forms. The rights one has either in a corporation or unincorporation are legal abstractions and not the reality of the expectations. If all you focus on is the model, perhaps you do see a real difference. But if you compare the model with the infinitely more complex real world, the importance fades.

In any case, it strikes me as a line of thought left unresolved by Larry's untimely passing, and one I would have enjoyed debating with him.

III. THE METAPHOR OF “CROWDING OUT” V. THE METAPHOR OF THE MACHINE

The foregoing is not just a reaction to academic theory. I am also wary of a kind of legal hyper-rationality in practice that creates lawyers' lawyers rather than business lawyers. I do not see modern sciences, institutions, or ways of thinking as “crowding out” the emotive aspect of commercial relationships. Indeed, I am inclined to believe that fear, greed, and panic are wholly capable of crowding out rationality even when it is just money at stake. I thus propose an alternative to the “crowding out” metaphor, one that has been operating with respect to law and lawyering at least since Langdell organized the first casebook on contracts: the metaphor of the machine.⁷²

Machines are the product of idealized science as applied to real life, the translation of universal regularities that underlie things like the internal combustion engine or the Salk vaccine into improvements of the human condition. When law became a social science, it became the subject of a search for universal regularities, and the metaphor of the ma-

70. *Id.* at 2.

71. See Ribstein, *Trust*, *supra* note 5, at 575.

72. For almost lyric exposition of this metaphor, see the section on “The Metaphor of the Corporate Machine” in JAMES CHAMPY, *REENGINEERING MANAGEMENT: THE MANDATE FOR NEW LEADERSHIP* 11–14 (1995).

chine took hold for lawyers as much as for business managers.⁷³ Lawyering actually performed by machines (the kind Bill Henderson describes⁷⁴) is merely another step in the progression; law reducible to universal principles in the Langdellian mode, or governed by welfare-maximizing economic law, was machine-like from the get-go. That is not surprising; the story of modernization, of organic *Gemeinschaft* giving way to organized *Gesellschaft*, itself invokes the metaphor of the machine.⁷⁵ The upshot is that the concepts of economic utility and legal rights are often useful but are nevertheless human-created fictions meant to model or crystallize a far more complex reality. Something may be happening when human beings decide to get things done in organizations (*Gesellschaft*) rather than live in tribes (*Gemeinschaft*). The modern conceit is that you can (supposedly) quantify utility or enforce rights, and so they ought to be real enough to crowd out *gemeinschaftlich* things like trust, fear, greed, or panic. And the crowding out is sufficiently measurable to be accounted for on a sliding scale.

I do not buy it. If we are going to talk in fictions, I prefer a different metaphor. I think of trust as something wholly distinct from the machine parts of the law in the complex systems of human relationships. Trust is instead the equivalent of real liquid or metaphoric liquidity in a complex system, whether physical, financial, or organizational and it must exist as a distinct and ever-present part of the system, or the system cannot operate. Physically, nuclear reactor meltdowns occur, whether at Three Mile Island, Chernobyl, or Fukushima in real life, or *The China Syndrome* in fiction, when there is insufficient water to cool the reactor core. Financially, complex international financial markets melt down when there is insufficient liquidity in the system. Whatever the underlying causes of the fiscal meltdown of 2008-09, it is widely accepted that the trigger was the seizing up of short-term credit markets; banks and financial institutions stopping lending and other institutions could not get the cash they needed to survive.⁷⁶ So I am pretty sure that Larry and I would have

73. Champy observes about the limits of the machine metaphor for business managers:

It had, and continues to have, tremendous appeal to all of us. Why? Because it is an *ideal*, a vision of perfected human activity. Human beings are just fine; we wouldn't be anything else. But we are undependable: We get distracted, tired, angry, lusty, and ornery. We get depressed, we're drawn this way and that, grumbling about doing what's good for us. We scheme and battle. Organizational machines, or so the metaphor wants us to believe, do not suffer from any of these disabilities.

Id. at 13.

74. See, e.g., William D. Henderson, *Losing the Law Business*, LEGAL WHITEBOARD (Mar. 27, 2013), <http://lawprofessors.typepad.com/legalwhiteboard/2013/03/losing-the-law-business.html>; Bill Henderson, *LPOs Stealing Deal Work from Law Firms*, LEGAL WHITEBOARD (Feb. 9, 2013), <http://lawprofessors.typepad.com/legalwhiteboard/2013/02/lpos-stealing-deal-work-from-law-firms.html>.

75. This refers to Ferdinand Tönnies's famous dichotomy. See FERDINAND TÖNNIES, *COMMUNITY AND CIVIL SOCIETY* 17 (Jose Harris ed., 2001) (1887).

76. In Alan Blinder's account, the bond bubble at the heart of the financial crisis of 2008-09 burst on August 9, 2007, when BNP Paribas halted withdrawals on three of its subprime mortgage funds, citing "the complete evaporation of liquidity in certain segments of the US securitization market[s]." BLINDER, *supra* note 69, at 90. Indeed, Blinder's description of the financial crisis explicitly links trust and liquidity: "Once [the] seeds of doubt are sown [about the ability of counterparties to pay what they owe], the scramble for liquidity begins in earnest, because, like it or not, markets are

agreed that within the metaphoric system of business organizations, trust (whatever it is) is an essential component of the liquid that keeps the machine-like parts from melting down. Larry himself metaphorically referred to a world governed wholly by trust as “frictionless.”⁷⁷

But the implication from Larry’s work is that systems in the unincorporate form would be somehow less machine-like and therefore more amenable to traditional trust than corporations. Perhaps in Larry’s conception the unincorporate model is a more benign machine, but it is a machine nonetheless. Whether corporate or unincorporate, the law’s structures are, metaphorically speaking, modern and machine-like. Traditional trust, on the other hand, is ancient and atavistic in the sense that, as human beings, we are not so far removed from the same inclinations to trust or to fear that predated the scientific age. I view traditional trust (or something similar that resists definition, reduction, or measurement) as equally essential lubrication to the metaphoric machine parts in either case. The difference between the corporation and the unincorporation is only a matter of degree; without trust to lubricate the cogs or act as a coolant in the system, the “machine” created by public or private law seizes up or melts down. In other words, there comes a point when an effective business lawyer is something other than a metaphoric engineer—he is perhaps instead a metaphoric psychoanalyst.⁷⁸ And the reason is that the machine of the law has its limits. Just as a nuclear engineer cannot prevent the meltdown once the water has boiled off, and central bankers cannot easily restore credit flows merely by pumping more money into the system,⁷⁹ lawyers cannot engineer legal solutions to business disputes when the trust has evaporated. And my intuition is that it is no different, in principle or in practice, whether we are talking about a corporation or an unincorporation.

IV. CONCLUSION

I continue to caution students, lawyers, and law professors against confusing between real machines and the idealization of reality as a machine, particularly when it comes to living the professional life of a lawyer or creating lawyerly constructs like business organizations. I do not think Larry would have disagreed with that advice. People have not stopped being people. And despite the rationality that goes along with

fundamentally built on trust—in particular, on trust that the other guy will pay what he owes you in full and on time. In worst cases, markets seize up.” *Id.*

77. Ribstein, *Trust*, *supra* note 5, at 569.

78. See Jeffrey M. Lipshaw, *What’s Going On? The Psychoanalysis Metaphor for Educating Lawyer-Counselors*, 45 CONN. L. REV. 1355, 1359 (2013).

79. In August 2007, the crisis in the mortgage securitization market reached the point that merely adding more liquidity to the financial system was insufficient to stem the tide. As Alan Blinder observes, the problem was not just liquidity but loss of confidence. So merely pumping more cash into the economy was not enough; the Federal Reserve also needed to reduce the federal funds rate, which it did not, apparently still more concerned about inflation than “the downside risks to growth.” BLINDER, *supra* note 69, at 92.

the kind of thoughtful *ex ante* planning Larry and I advocated in our casebook,⁸⁰ great lawyers realize that the planning—no matter the particular form employed—is just as likely to become obsolete the moment it is complete when real people and the real world are involved, and something a lot more like traditional trust than cost-benefit analysis operates to keep the system running. Perhaps a better way to think about it is that luck favors the prepared, and that the more we plan, the more we are free to react to circumstances that make the plan obsolete. That, of course, leads to the question of whether at that point you abandon the plan or stick to it, but that is a knotty question for another time.

80. RIBSTEIN & LIPSHAW, *supra* note 54, at 1–7.