Fiduciary Law and Economic Development: Attorneys as Trusted Agents in Nineteenth Century American Commerce

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Abstract

This article is the first to demonstrate the important role that fiduciary principles, and the attorneys who adopted them, played in American economic development.

Our original historical research shows that (1) lawyers were heavily involved as trusted agents in U.S. commerce during the nineteenth century, and that (2) their profession's devotion to fiduciary principles, which were developing roughly at the same time in Courts of Equity, enabled them to play this crucial role as intermediaries. We argue that lawyers thereby helped to solve agency problems (or problems of credible commitment) which economists consider to be critical for the development and growth of capitalist economies.

Our work brings together the methods of Institutional Economics and the New History of Capitalism. In so doing, we provide a perspective on U.S. economic development that considers the impact of legal culture on economic institutions. We demonstrate that the literature has failed properly to appreciate the significance of fiduciary law for U.S. economic development.

The article draws normative conclusions for the rule of law debate. It also draws normative conclusions for the current debate concerning the imposition of fiduciary duties on broker/dealers who give financial advice concerning retirement accounts. In a recent Presidential Memorandum Trump administration suggested that it might block the implementation of the fiduciary rule. Our analysis describes the value of the fiduciary rule in a way that is not appreciated by the literature.

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Table of Contents

I. Introduction **4**

II. The Early Nineteenth Century U.S. Economy **10**

III. Economic Development and the Agency Problem **13**

IV. Lawyers as Trusted Agents **17**

A. Confidence in the Legal Profession **17**

B. Lawyers as Commercial Agents **19**

1. Debt Collection 20
2. Land Sales 24
3. Transactional Support 26

V. The Construction of Professional Identity **29**

A. Development of the Law of Fiduciaries **29**

B. Professional Ethos **32**

VI. The Agency Problem and the Fiduciary Response **37**

A. Doctrine **37**

B. Anti-Opportunism **39**

C. Normative Significance, Reflective Judgment, and Production of Trust 40

D. Fiduciary Law Cannot Be Reduced To Contract **41**

VII. Policy Implications **44**

A. The Rule of Law Debate **44**

B. The Continued Relevance of Fiduciary Law **47**

VIII. Conclusion **51**

Fiduciary Law and Economic Development: Attorneys as Trusted Agents in Nineteenth Century American Commerce[1]

I. INTRODUCTION

What legal institutions promote economic development has been a focus for institutional economics.[2] This question continues to be a pressing public policy question and a major concern of law and development efforts.[3]

Institutional economists have argued that the ability of contracting parties to make credible commitments is essential to the rise of capitalist economies. In a world full of risk, such commitments require the support of institutions that reduce uncertainty and encourage exchange.[4] Without such support, self-interested parties would simply abandon agreements when their incentives change.[5] From this perspective, the judicial enforcement of contracts is central to economic growth.[6]

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[2] KENNETH W. DAM, THE LAW-GROWTH NEXUS 2 (2006); Michael Trebilcock & Jing Leng, *The Role of Formal Contract Law and Enforcement in Economic Development*, 92 VA. L. REV. 1517, 1520-1521 (2006).

[3] *See, e.g.*, ROBERT COOTER & HANS-BERND SCHAEFER, SOLOMON'S KNOT: HOW CAN LAW END THE POVERTY OF NATIONS (2012); Alvaro Santos, *The World Bank's Uses of the "Rule of Law" Promise in Economic Development*, *in* THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL 253 (David Trubek & Alvaro Santos eds., 2006).

[4] DAM, *supra* note 2, at 123ff; DOUGLAS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 33-35 (1990); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE (1996); Chantal Thomas, *Law and Neoclassical Economic Development in Theory and Practice: Toward an Institutionalist Critique of Institutionalism*, 96 CORNELL. L. REV. 967, 996-97 (2011).

[5] *See, e.g.,* Gillian K. Hadfield, *The Many Legal Institutions That Support Contractual Commitments*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 175, 180 (C. Menard & M. M. Shirley, eds., 2005).

[6] *See, e.g.,* DAM, *supra* note 2, at 123ff (2006); COOTER & SCHAEFER, *supra* note 3, at 10, 64-100 ("this book tells the story of how insecure property, unenforceable contracts…and other legal problems stifle business ventures and cause national poverty"); DOUGLASS C. NORTH & ROBERT P. THOMAS, THE RISE OF THE WESTERN WORLD (1973); NORTH, *supra* note 4, at 35, 54; WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 4; Darren Acemoglu & Simon Johnson, *Unbundling Institutions*, 113 J. POLIT. ECON. 949 (2005) (summarizing literature, but concluding that contract enforcement is less important); Darren Acemoglu & Simon Johnson, and J. A. Robinson, *Institutions As A Fundamental Cause of Growth*, *in* 1A HANDBOOK OF ECONOMIC GROWTH. 386 (P. Aghion and S. N. Durlauf eds., 2005); Andrés Fernández & César E. Tamayo, *From Institutions to Financial Development and Growth: What Are the Links?* 31 J. ECON. SURVEYS 17, 22 (describing "[t]he theory behind the [financial institutions] literature [as] hold[ing] that in countries where legal systems enforce private property rights, support private contractual arrangements, and protect the legal rights of investors, financial markets develop rapidly and are able to support real activity.); Stephen Knack and Philip Keefer, *Institutions and Economic Performance: Cross-County Tests*

Douglass North, one of the founders of institutional economics, maintains that "the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World."[7]

For economists like North, the nineteenth century American economy provides a case study of uniquely successful development. The American economy grew because "the underlying institutional framework persistently reinforced incentives for organizations to engage in productive activity."[8]

But recent historians of capitalism paint a messier picture. In their detailed accounts of everyday life under capitalism, they have observed the fraud that plagued the nineteenth century American economy,[9] illustrated the frequency of financial failures,[10] highlighted the devastating effects that financial swings had on the confidence of market participants,[11] and pointed out dozens of impediments to commercial transaction.[12] As a consequence of this literature, we know more about the social and cultural history of finance—about the ways that farmers, house wives, and laborers struggled with the consequences of becoming "market subjects" in an economy driven by disruptive economic forces.[13]

Using Alternative Institutional Measures, 7 ECON & POL. 207, 210-11 (1995); Daniel Klerman, *Legal Infrastructure, Judicial Independence, and Economic Development*, 19 PACIFIC MCGEORGE GLOBAL BUS. & DEV. L. J., 427-34 (2007) (describing the standard view of the importance of an independent judiciary as follows: "Good, independent courts enforce contracts and protect property, and by doing so encourage the investment which is crucial for economic development.); Thomas, *supra* note 4, at 996-97; Trebilcock & Leng, *supra* note 2; Avner Greif, Coercion and Exchange: How Did Markets Evolve? 1 (Nov. 19, 2008) (unpublished article), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1304204 ("Why did [the] modern market economy, characterized by impersonal exchange and formal institutions, first emerge in the West? …. The literature identified two conditions necessary for market economy; the security of property rights and contract enforceability.").

[7] NORTH, *supra* note 4, at 54.

[8] *Id.* at 9.

[9] *See, e.g.,* JANE KAMENSKY, THE EXCHANGE ARTIST: A TALE OF HIGH-FLYING SPECULATION AND AMERICA'S FIRST BANKING COLLAPSE (2008); STEVEN MIHM, A NATION OF COUNTERFEITERS (2007).

[10] *See, e.g.,* EDWARD J. BALLEISEN, NAVIGATING FAILURE: BANKRUPTCY AND COMMERCIAL SOCIETY IN ANTEBELLUM AMERICA (2001); SCOTT SANDAGE, BORN LOSERS: A HISTORY OF FAILURE IN AMERICA (2006).

[11] *See, e.g.,* ANN FABIAN, CARD SHARPS, DREAM BOOKS, AND BUCKET SHOPS: GAMBLING IN NINETEENTH CENTURY AMERICA (1990); JONATHAN LEVY, FREAKS OF FORTUNE: THE EMERGING WORLD OF CAPITALISM AND RISK IN AMERICA (2012); BRUCE MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2009).

[12] *See, e.g.,* BALLEISEN, *supra* note 10; FABIAN, *supra* note 11; KAMENSKY, *supra* note 9; LEVY, *supra* note 11; MIHM, *supra* note 9; SANDAGE, *supra* note 10.

[13] As Jean Christophe-Agnew has noted, this has provided detailed insight into the "flatland of ordinary material practices that habituated Americans to the new systematic rules of capitalism." *Afterward*, *in* CAPITALISM TAKES COMMAND: THE SOCIAL TRANSFORMATION OF NINETEENTH-CENTURY AMERICA 277, 280 (Michael Zakim & Gary J. Kornblith, eds., 2011); *see also* Guyora

Historians of capitalism have recognized that wealthy commercial actors were able to overcome the impediments to trade presented by the risky nineteenth century economy and have charted the rise of interconnected global markets for cotton, cloth, and other commodities.[14] But they have paid relatively little attention to the stabilizing institutions and governance mechanisms on which economists focus.[15]

Our work brings these two fields together. We use the tools of the New History of Capitalism to illuminate how fiduciary norms, diffused by lawyers, came to define the legal institution of agency. In so doing, we argue that the institutional economics literature has not adequately recognized the special resources that American legal culture has brought to bear on the problem of trust in agency relationships.

We focus on lawyers because their commercial work placed them at the center of American commerce. Lawyers, as Justin Simard has argued, played a critical role in mediating, negotiating, and executing economic transactions in early America.[16] On the frontier, they performed a diverse range of activities for their clients: They surveyed land, hired workers, paid taxes, collected notes, examined titles, brought suits, managed finances, transferred money and prepared detailed reports to send back East. In New York City, the story was the same: For real-estate investors, lawyers researched and examined titles; for traders, they drafted

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Binder & Robert Weisberg, *Cultural Criticism of Law*, 49 STAN. L. REV. 1149, 1192 (1997) ("Not only are modern markets constructed by the state definition and protection of entitlements, they depend upon the sustenance of a social and cultural order that constitutes and encumbers market actors, an order threatened by unrestricted alienability.").

For more on the consequences of becoming market subjects see, e.g., LEVY, *supra* note 11; SETH ROCKMAN, SCRAPING BY: WAGE LABOR, SLAVERY AND SURVIVAL IN EARLY BALTIMORE (2009); Tamara Plakins Thornton, "*A Great Machine" or a "Beast of Prey": A Boston Corporation and Its Rural Debtors in an Age of Capitalist Transformation*, 27 J. EARLY REPUBLIC 567-597 (2007).

[14] *See generally* SVEN BECKERT, EMPIRE OF COTTON: A GLOBAL HISTORY (2015); SVEN BECKERT, THE MONIED METROPOLIS: NEW YORK CITY AND THE CONSOLIDATION OF THE AMERICAN BOURGEOISIE, 1850-1896 (2001); Seth Rockman, *Negro Cloth: Mastering the Market for Slave Clothing in Antebellum America*, in THE NEW HISTORY OF AMERICAN CAPITALISM (Sven Beckert & Christine Desan, eds. Forthcoming 2017).

[15] *See* Agnew, *supra* note 13, at 277-78 (noting avoidance of "the classical components of capitalism's story" including "its entrepreneurial, managerial, [and] Marxist variants"). They have, however, identified the exploitation that supported nineteenth century commerce, exploitation that Eric Williams first drew attention to in the 1940s. *See* ERIC WILLIAMS, CAPITALISM AND SLAVERY (1994) (originally published in 1944). For recent work, *see, e.g.*, BECKERT, *supra* note 14; RICHARD HOLCOMBE KILBOURNE, JR., DEBT, INVESTMENT, SLAVES: CREDIT RELATIONS IN EAST FELICIANA PARISH, LOUISIANA, 1825-1885 (1995); ROCKMAN, *supra* note 13; Seth Rockman, *The Future of Civil War Era Studies: Slavery and Capitalism*, 2 J. CIVIL WAR ERA (2012), *available at* http://journalofthecivilwarera.org/forum-the-future-of-civil-war-era-studies/the-future-of-civil-war-era-studies-slavery-and-capitalism/.

[16] See *generally* Justin Simard, *The Birth of a Legal Economy: Lawyers and the Development of American Commerce*. 64 BUFF. L. REV. 1043 (2016).

agreements and settled disputes; for insurers, they prepared and interpreted policies; for manufacturers, they established financing and organized partnerships; and for bankers, they secured loans and deposits.[17]

We point out that, in commercial practice, lawyers served as the quintessential fiduciaries. They acted as trusted agents for their clients, exercising their discretion on behalf of, and in the best interests, of others. And by shepherding their clients through a hazardous economic landscape, lawyers gave them the confidence needed to participate in the market.

Lawyers played this trust-building role, not only because they were one of the few groups of Americans with the white-collar skills suited to conduct market transactions, but also because the ideology of their professional affiliation and their professional norms, made them more trustworthy. Despite their close ties to commerce, lawyers asserted that they kept a critical distance from the ruthlessness of the market. They claimed, as one New York lawyer put it, that "the profession of the law was not in and of itself the pursuit of gain" and maintained that a good lawyer worked hard, not for his own benefit, but for the benefit of his clients.[18] Lawyers thus saw themselves—or at least the leaders of the profession did—as situated outside of the market and motivated by ability and integrity rather than by an effort to get rich.

As fiduciaries, we argue, lawyers drew on a professional culture that was informed by principles of equity taken from the law of trusts. Equity developed principles to police trustees who controlled property for beneficiaries, just as lawyers did for their clients. These principles included prohibitions against self-dealing and profiting from transactions made on behalf of beneficiaries, even where such transactions were otherwise lawful. In their professional practice in the rapidly evolving commercial world, lawyers adopted and developed these fiduciary principles, as well as more specific rules that would later become the foundation for the law of lawyering.

Recognizing the important role that lawyers played in the development of American capitalism is significant, not only for understanding the importance of the legal profession to economic development in the United States but also for understanding the role of fiduciary legal institutions in constituting markets.

Although economists have devoted significant attention to the legal institutions for the enforcement of property and contract, they have paid significantly less attention to the law of fiduciaries. When they do, they view it not as a distinct form of equitable law, but rather as an "incomplete contract."[19] The

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[17] *See id.*

[18] MEMORIAL OF DANIEL LORD 74-75 (D. Appleton & Co. 1869).

[19] *See, e.g.,* Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. LAW & ECON. 425 (1993); Oliver Hart, *An*

agency-cost literature, for example, relies on a contractual approach to diagnose the problems posed by the delegation of discretion from principal to agent.[20] But this theoretical approach assimilates the historic fiduciary relationship to a contractual framework that deploys behavioral assumptions (such as self-interested behavior) and legal analysis (of contract) inconsistent with the special duties and norms of loyalty which distinguished "fiduciary agency" from contract.[21]

Our empirical research reveals that these duties and norms of loyalty were essential to making fiduciary law an effective legal institution for addressing the problems of trust in agency relationships in the bourgeoning capitalist markets of the nineteenth century United States. Lawyers, we argue, not only served as quintessential fiduciaries but also consciously developed fiduciary institutions. These institutions proved crucial to the construction of nineteenth century American markets, encouraging economic exchange in ways that property and contract law could not have done on their own.

Our work has both theoretical and practical implications. It shows that fiduciary principles and norms should be understood on their own terms[22] and should not be treated merely as default rules to contracts of agency, as the economic literature on this subject suggests.[23] This is because fiduciary principles and norms serve a critical trust-building function that distinguishes them from ordinary contract law and encourages a culture of honest services in private (and public)

Economist's View of Fiduciary Duty, 43 U. TORONTO L. J. 299 (1993); Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 197 (Andrew S. Gold & Paul B. Miller, eds., 2014).

[20] A seminal article for this literature is Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

[21] *See, e.g.*, Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 BOSTON COLLEGE L. REV. 595, 596 (1997) ("Neither 'contract' nor 'fiduciary' exist in nature. Each is a construct developed in legal discourse to serve normative as well as analytic functions. The contractarians appear to suggest that 'contract' and the consequences that contract doctrine prescribes better 'fit' or explain all the transactions and arrangements that have been characterized as 'fiduciary' than does the construct 'fiduciary' alone."); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (1988); Daniel Markovits, *Sharing Ex Ante and Sharing Ex Post*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY DUTY, *supra* note 19, at 209.

[22] Andrew S. Gold & Paul B. Miller, *Introduction to the Philosophical Foundations of Fiduciary Law*, PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 19, at 1, 1 (" Whether it is viewed from the perspective of relationships, rights and duties, or wrongs and remedies, fiduciary law is a distinctive body of law.")

[23] For this view, *see, e.g.*, Larry Ribstein, *Fencing Fiduciary Duties*, 91 BOSTON U. L. REV. 899, 900 (2011) ("fiduciary duty is most usefully viewed as a type of contract"); *Id.* at 919 ("The fiduciary duty is a useful tool for controlling agency costs. It makes sense to utilize it in the context of a particular type of agency relationship involving broad delegation of power to manage another's property. In this situation, a default duty of unselfish conduct is appropriate because lesser constraints on agency often are ineffective.").

organization.[24] Policymakers therefore need to take fiduciary law seriously. Prescriptions for economic development drawn from American economic history are incomplete unless they account for the functions of fiduciaries. So too are analyses of the modern American economy that do not recognize that fiduciary principles are still a critical part of the institutional framework supporting complex transactions.[25]

Part II describes the volatile economic conditions that prevailed in the nineteenth century United States.

Part III frames the difficulties that these economic conditions represented for economic exchange in terms of the institutionalist problem of agency costs or contracting.

Part IV relies on original archival research to describe the special role that lawyers played as agents in American commercial life.

Part V argues that reliance on fiduciary principles, originating with Courts of Equity, allowed lawyers to establish themselves as trusted agents in an economic climate rife with fraud. By adopting fidelity to clients as the ethical core of nineteenth century legal practice, lawyers distinguished themselves from self-interested market participants, and established professional norms that positioned lawyers as trustworthy agents.

Part VI argues that fiduciary laws and norms offered a particularly successful solution to agency problems in nineteenth century America because they deterred self-interested opportunistic contact and helped to define the social role of the trustworthy agent. It suggests that economists who view fiduciary law in terms of contract law underestimate the importance of fiduciary law because their theoretical approach abstracts from fiduciary law's normative content.

Part VII considers certain normative implications of our analysis for the rule of law debate and the current dispute about the extension of the fiduciary rule to all financial advisors.

Part VIII concludes.

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[24] Although we do not address the importance of fiduciary duty as a governance mechanism in the public sector, this function has been recognized by others. *See, e.g.*, RICHARD PAINTER, ETHICS IN GOVERNMENT (2010); Kathleen Clarke, *Do We Have Enough Ethics in Government Yet?: An Answer from Fiduciary Theory*, 1996 U. ILL. L. REV. 57.

[25] For a critique of this view, see, e.g., Tamar Frankel, *Watering Down Fiduciary Duties*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY DUTY *supra* note 19, at 242; *see also* Lawrence Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675 (1990).

II. THE EARLY NINETEENTH CENTURY U.S. ECONOMY

In the nineteenth century, the American economy grew at an unprecedented rate. Whereas relatively stagnant economies were the norm throughout much of human history, by 1800, the United States economy began to expand two percent a year for the rest of the nineteenth century.[26] Despite massive population growth, GDP per capita in the United States jumped from $1,257 in 1820 to $2,445 by 1870.[27]

Economic growth did little, however, to mask the difficulties that a complex economy created for those active in commerce. Recent historians of capitalism have documented the pervasiveness of failure and the effects it had on the livelihoods and perceptions of nineteenth century Americans.[28] Economic downturns, known in the nineteenth century as panics, seemed to occur without any obvious cause.[29] Nearly one in four Americans living in the early nineteenth century became insolvent during their lifetimes.[30] Businesses failed at an even greater rate.[31] Americans not only recognized the risk but also exaggerated it. A well-circulated rumor suggested that ninety five percent of merchants became insolvent.[32] Although some found ways to make peace with the market's swings, they were unable to eliminate them.[33] Unfortunately, for those who faced the

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[26] Peter H. Lindert & Jeffrey G. Williamson, *American Incomes 1774-1800* tbl.4 (Nat'l Bureau Econ. Res., Working Paper No. 183996, 2012); *see also* Derek Thompson, *The Economic History of the Last 2000 Years: Part II*, ATLANTIC, June 20, 2012, http://www.theatlantic.com/business/archive/2012/06/the-economic-history-of-the-last-2000-years-part-ii/258762/.

[27] ANGUS MADDISON, THE WORLD ECONOMY: A MILLENNIAL PERSPECTIVE tbl.B-21 (2001) (providing inflation adjusted GDP numbers). Between 1820 and 1870, the population of the United States more than quadrupled, from 9,638,453 to 38,558,371. U.S. CENSUS BUREAU, 1820 UNITED STATES FEDERAL CENSUS; U.S. CENSUS BUREAU, 1870 UNITED STATES FEDERAL CENSUS.

[28] *See supra*, notes 10-16.

[29] The first of these seemingly inexplicable panics occurred in 1819. *See* JOHN LAURITZ LARSON, THE MARKET REVOLUTION IN AMERICA: LIBERTY, AMBITION, AND THE ECLIPSE OF THE COMMON GOOD 39-45 (2009). Prior panics could be blamed on "drought, revolution, or wartime embargoes." See SANDAGE, *supra* note 10, at 29.

[30] According to one historian's calculations almost seventy percent of merchants in 1850 San Francisco failed. *See* SANDAGE, *supra* note 10 at 7 (citing PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900 at 287-88 (1974).

[31] *Id.*

[32] *Id.* at 7-8; Edward Balleisen pegs the rumored number at a still unbelievable 95 percent. *See* BALLEISEN, *supra* note 10, at 3.

[33] The swings of the market created serious stress for market participants. *See generally* SANDAGE, *supra* note 10; LEVY, FREAKS OF FORTUNE, *supra* note 11. Americans dealt with the stress posed by a turbulent market in various ways. Some sublimated their fears by turning to reform campaigns, attacking gambling and the random risks it posed, thereby distinguishing the market's rewards as based on rationality rather than chance. *See* FABIAN, *supra* note 11, at 59-107. Others killed themselves when faced with economic ruin. SANDAGE, *supra* note 10, at 6-7. Still others

consequences of a volatile market, volatility and growth were linked. The increasingly complex American economy that relied on distant and anonymous transaction also created opportunities for fraud and economic loss.[34] By the early nineteenth century, traders could no longer depend on the application of social pressure in close-knit communities to force the repayment of their debts or discourage fraud.[35] Increasingly distant and anonymous transaction also meant that businesses could not rely on direct observation of trading partners or clients.

In addition, relatively rudimentary transportation made it difficult to monitor trading partners from a distance.[36] A trip from South Carolina to Connecticut in 1809, for example, took one healthy young man nearly a month.[37] Such trips were as difficult as they were slow; they involved perilous bridge crossings, expense, and multiple forms of transportation.[38] Travel west took just as long, and forced travelers to endure treacherous stream crossings, "arm[ies]" of fleas and bed bugs, "excessively muddy" roads, and "poor water."[39] Communication could also be slow, expensive, and unreliable. Although the postal service played an important role in connecting Americans across the country, it was also hindered by the difficulties of travel and the expensive of postage.[40] Even in

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embraced the "mania for speculation," engaging in confidence games, fraud, and counterfeiting. MIHM, *supra* note 9, at 15; *see also* KAMENSKY, *supra* note 9.

[34] *See generally* EDWARD J. BALLEISEN, FRAUD: AN AMERICAN HISTORY FROM BARNUM TO MADOFF (2017).

[35] In the seventeenth century, when commerce was mostly local, it was easier to apply social pressure and use other informal means of persuasion to ensure that loans were repaid. Resort to formal legal means to redeem debts was rare. Communal connections, however, eroded significantly by the mid-eighteenth century, making informal forms of debt redemption less effective. *See* BRUCE MANN, *NEIGHBORS AND STRANGERS*: LAW AND COMMUNITY IN EARLY CONNECTICUT 101-136 (2001); *but see* Claire Priest, *Currency Policies and Legal Development in Colonial New England*, Yale L.J. 1303, 1395 (2001) (arguing that the rise of debt cases had less to do with the erosion of communities than with a series of depreciation, currency scarcity, and economic recession);

The effectiveness of social pressure was even slighter for trading partners who were separated by significant distance and shared only commercial connections. By the early nineteenth century, social pressure was therefore both less effective and less appealing than it once had been. *See* ROBERT WRIGHT, ORIGINS OF COMMERCIAL BANKING IN AMERICAN, 1750-1800 at 29 (2001).

[36] *See* SANDAGE, *supra* note 10, at 99-188 (credit reporting); DANIEL WALKER HOWE, WHAT GOD HATH WROUGHT: THE TRANSFORMATION OF AMERICA*,* 1815-1848 at 211-42, 563-69, 690-98 (2009) (transportation).

[37] The traveler thought his trip was significant enough to justify recording in a detailed journal. *See* WILLIAM DICKINSON MARTIN, JOURNAL: A JOURNEY FROM SOUTH CAROLINA IN THE YEAR 1809 10, 41, 42 (Anna D. Elmore ed., 1959).

[38] *Id.*

[39] HENRY LEAVITT ELLSWORTH, A TOUR TO NEW CONNECTICUT IN 1811: THE NARRATIVE OF HENRY LEAVITT ELLSWORTH, 37, 54, 19, 56, 60-61, 64, 66, 70, 72, 74 (Phillip R. Shriver ed., 1985); *see also* MARGARET VAN HORN DWIGHT, A JOURNEY TO OHIO IN 1810, at 5, 6, 47 (Max Farrand ed. 1991); Joseph BADGER, A MEMOIR OF REV. JOSEPH BADGER, CONTAINING AN AUTOBIOGRAPHY, AND SELECTIONS FROM HIS PRIVATE JOURNAL AND CORRESPONDENCE 22-26 (Hudson, OH, 1851).

[40] DAVID M. HENKIN, THE POSTAL AGE: THE EMERGENCE OF MODERN COMMUNICATIONS IN NINETEENTH CENTURY AMERICA (2006).

the 1850s, Americans sent an average of only five letters a year.[41] Those who depended on parcels for business found ways to work around the postal service's limitations by sending them with friends or trusted travelers.[42] Other technologies that sped up communication, such as railroads and the telegraph, were not widely adopted until later in the nineteenth century.[43]

An unreliable money supply exacerbated the problems of long-distance exchange. Because the Constitution had banned the printing of paper currency by the states, and because the federal government did not print paper money until the Civil War,[44] Americans active in commerce depended on bills of exchange and private bank notes as substitutes for cash.[45] Both substitutes had problems. Bills of exchange, which were promises to pay made on an individual basis, depended on the solvency (and integrity) of a distant trading partner or his financial backer. If a businessman failed to pay what he owed, it might be difficult or impossible to track him down or to seize his assets. Failures could also compound. One businessman's inability to pay might cause problems for hundreds of others who were depending on his money to maintain payments on the webs of debt that enmeshed many commercial actors.[46] Banknotes, on the other hand, depended entirely on the solvency of private banks, which at the time were nearly unencumbered by regulations on deposits.[47] Dishonest bank proprietors issued notes without any backing and even honestly operated banks failed during panics.[48] Counterfeit notes also circulated widely, with contemporaries estimating that counterfeit notes ranged

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[41] *Id.* at 17.

[42] Lawyers in Ohio, for example, complained about the postal service's delays and made efforts to ensure the security of Letters. *See* Letter from Elisha Whittlesey to Elisha Sterling (Sep. 3 1810) (on file with the W. Reserve Historical Soc'y) (discussing sending letters with visitors rather than postal service); Letter from D. Whittlesey to Elisha Whittlesey (June 1, 1816) (on file with the W. Reserve Historical Soc'y) (discussing difficulties with communication); Letter from E.D. Whittlesey to Elisha Whittlesey (March 24, 1817) (on file with the W. Reserve Historical Soc'y) (explaining process of cutting bills of exchange in half and sending separately in order to prevent theft).

[43] See HOWE, *supra* note 36, at 211-42, 563-69, 690-98; HAROLD D. WOODMAN, KING COTTON AND HIS RETAINERS 273-4 (2000).

[44] MARGARET GOOD MYERS, A FINANCIAL HISTORY OF THE UNITED STATES 72, 163 (1970) (discussing effect of National Banking Acts of 1863 and 1864); *see* National Banking Act of 1863, 12 Stat. 665 (1863); National Banking Act of 1864, 13 Stat. 99 (1864).

[45] Article I, Section 10 of the Constitution barred states from coining money, emitting "Bills of Credit," and making "any Thing but gold and silver Coin a Tender in Payment of Debts." U.S. Constitution, Art. I. Sec. 10. Specie, the only officially backed form of exchange,

[46] *See* MANN, *supra* note 35, at 14-17, 28-35.

[47] MIHM *supra* note 10, at 14. As Mihm describes, "A host of laws and regulations sought to restrain both legitimate and illegitimate commerce. But such codes, largely instituted and (imperfectly) enforced on a local level, did little regulate either legal or illegal commercial transactions that stretched beyond village or city jurisdictions, state lines, or even national boundaries. Whatever their intent, laws had rather limited bearing on either the corporations that issued bank notes or the counterfeiters who imitated them." *Id.*

[48] *Id.*

from 10 to 50 percent of currency in circulation.[49] Thanks to the "ubiquity of counterfeiting," bank notes sometimes traded at high discounts.[50] In short, Americans engaged in trade and manufacturing relied on private IOUs and dubious bank notes, because that was what they had.[51]

The nineteenth century American economy, then, was far from a perfect environment for exchange. Market volatility, anonymous transaction at a distance, fear of failure, slow transportation and communication, and lack of a reliable means of exchange combined to create significant obstacles to commercial activity. Limited regulation by municipalities, states, and the federal government did little to reign in the excesses of nineteenth century commerce.[52] In this volatile market, trust was an extremely valuable commodity.

III. Economic Development and the Agency Problem

Institutional economists make the problems of uncertainty and trust in economic exchange central to their account of economic development.[53]

The institutionalist literature explains the persistence of inefficient economic exchange during much of history, and in most nation states, by the absence of institutions to secure property rights and enforce contracts.[54] Without these institutions, they argue, transactions costs are prohibitively high. In the absence of secure property rights and expropriatory threats, entrepreneurs would "not only reduce investment," but "also invest in less specialized capital (human and physical), which can be moved more easily from one activity to another."[55] Capitalist economic development is driven by highly specialized capital investments that dramatically increase the scale and scope of production. Moreover, such investments depend on the ability of rational actors to develop contractual relationships under conditions of uncertainty. Without reliable institutions, advanced capitalist development could not have taken place.

One of the central problems of economic exchange is the agency problem.[56] Economists argue that the agency relationship gives rise to special problems of contracting that derive from the discretion that is afforded to agents and the

[49] *Id.* at 6

[50] *See id.* at 6; KAMENSKY, *supra* note 9, at 51-52; The demand for currency was so strong, however, that even counterfeit notes served an important role in exchange. *See* MIHM, *supra* note 10, at 15.

[51] *Id.*

[52] *Id.* at 14.

[53] Hadfield, *supra* note 5, at 175.

[54] *See supra* notes 6-7 and accompanying text.

[55] Donald Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 51 AM. J. COMP. L. 89, 90 (2003) (citing Knack & Keefer, *supra* note 6, at 219).

[56] Hadfield, *supra* note 5, at 175.

resulting information asymmetry between the agent and the principal.[57] Because the agent's discretionary acts are imperfectly observable by the principal, the agent has opportunities to deviate from the principal's instructions and pursue his own self-interest at the expense of the principal. Jensen and Meckling describe such incentives in terms of "moral hazard" and "shirking."[58]

Moral hazard and shirking are exacerbated by the difficulty of ascertaining the reliability of an agent. When hiring the agent, *ex ante*, the principal has imperfect knowledge of the character of the agent, that is, whether the agent is of such character that he will tend to shirk his duties or expend his best efforts on behalf of the principal. *Ex post*, because of the uncertainties and contingencies surrounding the exercise of the agent's judgment, the principal cannot be sure that the agent applied his best efforts in carrying out the business of the principal.

Because the adverse selection problem and the information asymmetry of the principal-agent relationship are understood *ex ante* by the principal, economists argue that the principal will therefore seek to discount the value of the agent's services. The discount reflects the special transaction costs that arise from the agency relationship. They may be mitigated by the agent bonding himself or by the principal's monitoring of the agent. But both mitigating strategies are costly and imperfect.[59] In the words of North, "[i]t is because we do not know the attributes of a good or service or all the characteristics of the performance of agents and because we have to devote costly resources to measure and monitor them that enforcement problems do arise."[60] When such costs become too great, or in the absence of institutions that allow contracting parties to make credible commitments, exchange will not take place at all.

The institutional economic literature charts the way that institutions can reduce uncertainty and encourage exchange. This literature focuses on property and contract rights as the core institutions of modern economic development.[61] North, for example, made the claim that "impersonal exchange with third-party enforcement…[via an effective judicial system] has been the crucial underpinning

[57] Sitkoff, *supra* note 19, at 197; Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

[58] *Id.*

[59] Economists understand the agency problem in terms of the theory of incomplete contracting. In order to resolve any conflicts that might arise ex post between the principal's purposes and the agent's conduct, their contract might in theory set forth infinitely specific terms ex ante. Here, the very benefit of the agency relationship depends on the ability of the agent to exercise discretion. But full specification of any contract is impossible. Full specification would entail excessive transaction costs and is, furthermore, impossible for epistemological reasons. *See infra* notes *230*-240 and accompanying text.

[60] NORTH, *supra* note 4, at 32.

[61] DAM, *supra* note 2, at 123ff; NORTH, *supra* note 4, at 33-35; WILLIAMSON, MECHANISMS, *supra* note 4; Thomas, *supra* note 4, at 996-97.

of successful modern economies involved in the complex contracting necessary for modern economic growth"[62] and that "the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World."[63] The institutionalist approach has been influential with international agencies engaged in rule of law reform.[64]

A somewhat different conceptualization of the agency problem is advanced by Oliver Williamson's "transaction cost economics".[65] Williamson describes the main problem of complex contracting and economic organization as the problem of "credible commitments" in a world in which at least some human beings engage in "opportunistic behavior" at least some of the time.[66] He defines "opportunism" as "self-interest seeking with guile,"[67] including "lying, cheating, and stealing,"[68] and makes it a behavioral assumption of his approach. Williamson's transaction cost approach considers the ability of courts to address agency/commitment problems through contract enforcement as limited. But he does not believe that all contracts are self-enforcing.[69] Rather, he argues that private ordering through complex contracting and organizational structure can be fruitfully investigated and explained as responses to the problems of making credible commitments that anticipate opportunistic conduct.[70] And credible commitments depend on how contracts are written and what governance structures, or "adaptive sequential decision making and dispute settlement" rules, are agreed upon by the parties to a particular economic exchange.

In working with opportunistic conduct to explain complex contracting and economic organization, Williamson suggests we are "better served by treating commercial transactions without reference to trust."[71] "What transaction cost economics says … is that because opportunistic agents will not self-enforce open-ended promises to behave responsibly, efficient exchange will be realized only if

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[62] NORTH, *supra* note 4, at 90.

[63] *Id.* at 54.

[64] *See, e.g.*, DAM, *supra* note 2; Santos, *supra* note 3, at 286 ("The work of Douglas North, in particular, had a strong impact on the way development policymakers began to think about law and legal rules as institutional foundations for a market economy.").

[65] *See* WILLIAMSON, MECHANISMS, *supra* note 4, at 171-194 (comparing the two approaches).

[66] Oliver E. Williamson, *Opportunism and Its Critics*, 14 MANAGERIAL DECISION ECON. 97, 99 (1993).

[67] WILLIAMSON, MECHANISMS *supra* note 4, at 6.

[68] Williamson, *supra* note 66, at 101.

[69] *Id.* at 97.

[70] For example, the integration of productive activity in a single firm, according to Williamson, can be attributed to the excessive risks or transaction costs that would be incurred (given the threat of opportunistic conduct) if inputs were to be obtained by market contracting. Thus, a standard problem of "hold-up" arises where a supplier makes asset specific investments to produce a good for a single customer. The recognition *ex ante* that either party may hold-up the other party may lead to integration of the productive activity. *Id.*

[71] *Id.* at 99.

dependencies are supported by credible commitments."[72] What is significant for our purposes is that Williamson, like North, works within the neo-classical assumption of self-interested conduct by rational agents and considers contract as the framework for understanding the economic institutions of capitalism.[73]

The agency problem has occupied economists and other social scientists, because agency relationships are so fundamental for economic development. Agency relations "fuel social differentiation" and promote the division of labor and the specialization of functions that characterize a complex economy.[74] They allow a principal who lacks certain abilities or knowledge to, nonetheless, deploy them for his own purposes.[75] Such demand, in turn, provides the incentive for agents to specialize. Other types of agency relationships simply answer to "the need to delegate responsibility for performing tasks of which the principal is capable."[76] Such opportunity permits the principal to specialize. Both types "initiate and facilitate collective forms of action,"[77] and provide the building blocks for hierarchy and more complex economic organization, including partnerships and corporations.[78] "No one has the skills necessary to do everything for himself," and "every undertaking has an opportunity cost."[79] "By delegating a task to an agent, the principal benefits from the specialist service and is freed to undertake some other activity."[80]

Substantial efficiencies thus flow from delegating to agents.

These include the ability to put property to use at a distance. Delegation of authority allows the agent to make use of property when the principal could not. Agency relationships thus bridge physical and social distances that limit exchange. And they allow an agent to put a principal's property to use over time. This permits the investment of property as well as the pooling of investments.[81] Agency relationships are therefore especially important in complex economies characterized by anonymity, diversity, and high specialization of functions.[82]

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[72] *Id.* at 100.

[73] WILLIAMSON, MECHANISMS OF GOVERNANCE, *supra* note 4, at 10; WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM , *supra* note 4.

[74] Susan P. Shapiro, *The Social Control of Impersonal Trust*, 93 AM. J. SOC. 623, 626 (1987).

[75] Barry Mitnick has called this "contentful agency." Barry M. Mitnick, *The Theory of Agency: The Fiduciary Norm* (unpublished paper) (on file with authors).

[76] Shapiro, *supra* note 74, at 627 fn. Barry Mitnick has called this "practical" or "structural" agency. *Id.*

[77] Shapiro, *supra* note 74.

[78] As such, agency relationships should be distinguished from simple, market-based exchange. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PENN L. REV. 1735 (2001).

[79] Sitkoff, *supra* note 19.

[80] *Id*.

[81] Shapiro, *supra* note 74, at 628.

[82] Agency relationships are found even in simple types of social organization, as in the division of labor in the nuclear family, or any kind of social hierarchy. In simpler types of social

It is therefore worth asking how nineteenth century Americans actually solved agency problems, and investigate the agents on whom they did rely.

IV. LAWYERS AS TRUSTED AGENTS

In the mid-nineteenth century, lawyers acted as agents for their clients, remotely conducting business on their clients' behalf, and serving as important intermediaries in commercial life throughout the United States. Acting in such capacity, lawyers had a critical role in helping to establish trust and confidence in transactions that were conducted in new and uncertain markets. This confidence was supported both by the lawyer's capacity to bring local knowledge and substantive expertise to bear on such transactions and by his adoption of (potentially enforceable) norms – which we would now call "professional conduct rules" -- that addressed the increased risk of abuse that their role as such agents presented.

A. Confidence in the Legal Profession

Businessmen consistently demonstrated confidence in the legal profession. They demonstrated this confidence both in writing, where business and legal manuals vouched for the usefulness and trustworthiness of lawyers, and in practice, where businessmen consistently relied on lawyers as agents, even when their work could not be easily monitored.

Laymen's legal guides, which were designed to provide the legal knowledge necessary for Americans engaged in commerce to undertake basic legal tasks themselves, provide surprising and frequent testimony to the virtues of commercial lawyers. A manual that explained the basics of promissory notes and credit, for example, spoke of the benefits of the "collection agency," which could put a creditor in touch with one an "attorney[] of good standing in every city and town of the United States."[83] Thus, even a book that was likely purchased by someone attempting to avoid consulting a lawyer encouraged its buyer to entrust the collection of debts to a lawyer hundreds of miles away whom he had never met and who he could not easily monitor. Similarly, THE MAN OF BUSINESS, A PRACTICAL MANUAL, a book that provided a rudimentary background on the laws

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organization, social scientists have identified agency relationships based on kinship, tribal relations, or other close-knit social relationships. Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 AM. J. SOC. 481 (1987). In more complex societies and economies, however, agency relationships by necessity depend on more than kinship, tribal, or even social ties. *Id. See also*, DAM, *supra* note 4, at 125 ("Economic development today depends on long-term contracts where relational factors either are not present or cannot suffice.").

[83] JAMES D. MCCABE, THE NATIONAL ENCYCLOPAEDIA OF BUSINESS AND SOCIAL FORMS 333 (Philadelphia, Nat'l Pub. Co. 1879).

of collection, also explained the fee arrangement that its buyer would need to pay a lawyer in collection cases.[84]

Others books more directly testified to the trustworthiness and loyalty of good lawyers, underscoring the image that lawyers themselves cultivated of a reliable profession devoted to client service. Benjamin Swaim's guide to business, for example, explained that when a businessman consulted a lawyer he would receive "safe and correct advice."[85] Edwin T. Freedley's *A Practical Treatise on Business,* went further, explaining in detail the usefulness of a lawyer to a man of business:

> Experience has conclusively convinced me that it would be positive economy for every man whose contracts are at all complicated, in fact, whose business is not of the simplest kind, to choose at the outset of his career an able attorney, which whom to consult and advise before concluding any important undertaking. . . . [Attorneys] are generally men who can see as far through a millstone as the miller himself, and a conversation with them will frequently remove the film by which anxious cupidity sometimes obscures the sight. To save men from lawsuits is the noblest office of their profession.[86]

Lawyers, in short, were not a cost to avoid, but a serious asset to a man of business. They did not selfishly foment lawsuits to earn higher fees but instead worked intently to prevent them. Their advice was not to be looked at warily but listened to intently. They should not be kept at arm's length but rather included in the most important activities of a business. Implicit in the accounts of such business manuals was a belief that lawyers were trustworthy fiduciaries, to whom businessmen could safely delegate discretion.

This was not merely talk. As we shall see, clients delegated significant discretion to their lawyers—to collect debts, sell land, and manage transactions—even when their actions took place at distance and demanded legal expertise or local knowledge and therefore could not be easily monitored. Businessmen trusted lawyers to evaluate land, make dozens of transactions on their behalf without supervision, accurately account for their actions, and even to pay themselves.

Not only did businessmen evidence their trust by relying on lawyers, they also did so by developing long-standing relationships with them. An eastern land speculator, for example, might rely on his lawyer to conduct his business in the west for thirty years.[87] Ties like these developed in New York as well. The Atlantic Insurance Company shared a decades long relationship with its primary

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[84] I.R. BUTTS, THE MAN OF BUSINESS, A PRACTICAL MANUAL 120 (Boston, I.R. Butts 1854).

[85] BENJAMIN SWAIM, 2 THE MAN OF BUSINESS, OR, EVERY MAN'S LAW BOOK 419-20 (Greensborough, N.C., William Swaim 1834).

[86] EDWIN T. FREEDLEY, A PRACTICAL TREATISE ON BUSINESS: OR HOW TO GET, SAVE, SPEND, GIVE, LEND, AND BEQUEATH MONEY: WITH AN INQUIRY INTO THE CHANCES OF SUCCESS AND CAUSES OF FAILURE IN BUSINESS 119 (Philadelphia, Lippincott, Grambo, & Co. 1852).

[87] Correspondence exists in Elisha Whittlesey's papers from 1806 to 1833. *See* Elisha Whittlesey Papers (1806-1833) (on file with the W. Reserve Historical Soc'y).

legal advisor,[88] referred to him as a "counsellor to the . . . company," and invited him to give a speech at a celebratory affair honoring the company's founder and chairmen.[89] John Jacob Astor extended his lengthy relationship with his lawyer past his death. In addition to making him the executor of his estate, he named him as one of the trustee of his charitable bequests.[90] Other families developed relationships with their lawyers that spanned generations.[91] The length and closeness of the ties between lawyers and their clients suggest that the client-lawyer relationship often amounted to more than simple arms-length contract for services.

B. Lawyers as Commercial Agents

Of the hundreds of tasks recorded in the account books and legal papers of attorneys, few involved the high-level doctrinal disputes that have tended to attract historians. Instead, the books show that lawyers spent their time drafting documents, giving advice, securing notes, and undertaking other straightforward, even mundane, tasks. Lawyers' papers also show that they did not confine themselves to narrowly defined "legal" work. Lawyers drafted writs to redeem debts, but they also tracked down debtors and negotiated settlements. They prepared mortgages, but they also examined land and performed title searches. They provided legal advice, but they also managed their clients' commercial accounts.

In the turbulent world of nineteenth century commerce, lawyers helped to bridge the gap between clients and their distant trading partners. Effectively, lawyers invented the white-collar service economy. Lawyers therefore served roles later played by bankers, accountants, collection agencies, real-estate agents, managers, credit reporters, title agents, and salesmen. Attorneys occupied these

[88] *See* Daniel Lord, Ledger (1831-38) (on file with John D. Gordon III); Daniel Lord, Ledger (1839-1844) (on file with John D. Gordon III); Daniel Lord, Daybook (1857-65) (on file with John D. Gordon III); Daniel Lord, Daybook (1865-1868) (on file with John D. Gordon III). They may have also relied on his firm after his death, but I did not have access to those records.

[89] *See* FREEMAN HUNT, 1 LIVES OF AMERICAN MERCHANTS 419 (New York, Hunt's Merchant Mag. 1856).

[90] *Astor Will Net's $5,000 A Year as Executor*, BOSTON DAILY ATLAS, Apr. 1, 1848; *John Jacob Astor's Gift,* N.Y. TIMES, Oct. 30, 1881. Daniel Lord was one of twelve trustees. The others were Washington Irving (the author), William B. Astor (John Jacob Astor's son), James G. King (businessmen, politician, and Litchfield graduate), Joseph G. Cogswell, Fitz-Green Halleck (the poet), Henry Brevoort (rich New York landowner), Samuel B. Ruggles (politician and large New York landowner), Samuel Ward (banker), Charles Astor Bristed (scholar and Astor's son-in-law), the Chancellor of New York, and the Mayor of the City of New York. *Id.*

[91] Daniel Lord, for example, developed a more than fifty yearlong relationships with members of the Crary family. See Daniel Lord, Ledger, 1815-1823, Collection of John D. Gordan III, Norwalk, CT (Hereinafter "JG"); Daniel Lord, Letters, 1864-65, JG; He also developed a lengthy relationships with the DeForest family and with Astor's children. See, e.g., Daniel Lord, Ledger, 1815-1823, JG, listing charges for De Forest and Son, John De Forest, L & G De Forest, Lockwood De Forest, John H. De Forest, and David C. De Forest; Daniel Lord, Ledger (1847-1856) (on file with John D. Gordon III).

diverse roles across the country, helping their clients to overcome the difficulties of nineteenth century trade by providing legal expertise, local knowledge, access to social networks, and ultimately, the ability to participate in economic activity from a distance.

The benefits that transacting through lawyers provided came with the potential for abuse. The risks of agency relations between attorneys and their clients, lay in the danger that attorneys would pursue their own self-interest in advising clients and conducting transactions on their behalf – to the detriment of their clients' interests. The opportunities for abuse increased the greater the discretion afforded to attorneys, the more the client depended on the attorney for information, and the greater the difficulty of monitoring the attorney's conduct due to physical distance or otherwise. Lawyers might engage in self-dealing, short-change clients to benefit a competitor, use information gained during the representation for their own purposes, take opportunities available to the client for themselves, take bribes from third parties, or engage in outright fraud.

Our empirical evidence suggests that these risks did not prevent clients from delegating significant discretion to their lawyers.

1. *Debt Collection*

One of the most important roles lawyers played was in helping their clients to navigate an economy that, thanks to the dearth of circulating currency, relied on promissory notes for exchange. These notes depended on the solvency of their private backers. Because they were often traded at a distance, commercial actors could not easily track down and confront those who did not pay when the notes came due, nor could they conveniently rely on personal connections to ensure repayment. They therefore relied on lawyers to help them navigate the distance and the legal complexities of note redemption. Legal account books and correspondence reveal that lawyers spent a significant portion of their time collecting debts, often for out-of-state creditors.

Roger Minott Sherman's early nineteenth century Connecticut practice provides a useful example. Debtors would write to Sherman to request his help to recover from a local debtor, including a copy of the note they wanted collected.[92] Sherman's job was to track down and confront delinquent debtors, forcing them to pay. Collection was the goal of the New York merchants, Cannon & Jarvis, who wrote to Sherman on October 2, 1797.[93] Enclosing a note against "Abel Belknap & Son," the merchants requested that the lawyer first "call on Mr. Belknap" to ascertain whether he would "pay the note" at "ten & half Dollars per Barrell." If so, they wanted Sherman to "settle in that way."[94] If Belknap were unwilling to

[92] *See, e.g.,* Letter from Cannon and Jarvis to Roger Minott Sherman (Feb., 1797) (on file with Fairfield Museum & Hist. Center).

[93] *Id.*

[94] *Id.*

settle, however, they requested that Sherman "attach sufficient property" in Belknap's mill to "secure the payment."[95] They expected Sherman to update them on the process at his "first opportunity."[96]

When collection efforts were unsuccessful, as was the case for Cannon & Jarvis, Sherman's clients had a more difficult choice. Bringing a case to court cost—and might waste—time and money. As the historian Bruce Mann has illustrated, debtors sometimes took advantage of procedural tactics to delay financial embarrassment or repossession of their property.[97] In addition to relying on procedure to buy time, debtors could also hide their property (or themselves) from legal process, making use of laws that shielded certain types of property from seizure.[98] In any case, turning to the court meant that Sherman's client would have to pay fees and sometimes deal with appeals. Even if Sherman's client prevailed in court, he could face the difficulty of collecting money from a debtor who had no assets to seize. Thus, confronted with the cost, difficulty, and delay of trial, many of Sherman's clients preferred to avoid court altogether. Some directly ordered Sherman to settle. Others gave him the power to pursue legal remedies if settlement attempts failed.[99]

By necessity, therefore, out-of-state clients, depended significantly on a lawyer's discretion. Not only did he have greater legal expertise than they did, he also had access to much better local knowledge about the debtor's situation. Sherman's clients often lived beyond the boundaries of Fairfield County and even across state lines.[100] Because Sherman's clients lived hours away from the people

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[95] *Id.*

[96] *Id.; see also* Roger Minott Sherman, Account Book, 1796-1804 (on file with Fairfield Museum & Hist. Center).

[97] MANN, *supra* note 35, at 18-23, 30.

[98] *Id.*

[99] *See, e.g.,* Letter from Robert Fairchild to Roger Minott Sherman (Sep. 12, 1812) (on file with Fairfield Museum & Hist. Center) (noting willingness to lower his expectations for the amount that Sherman could recover for him); Letter from Richard Bayan to Roger Minott Sherman (April 20, 1832) (on file with Fairfield Museum & Hist. Center) (requesting settlement); Letter from Lyman Law to Roger Minott Sherman (Nov. 2, 1825) (on file with Fairfield Museum & Hist. Center) (writing to Sherman that he was willing to accept "depreciation of bills"); Letter from Benjamin Strong to Roger Minott Sherman (June 25, 1803) (on file with Fairfield Museum & Hist. Center); Letter from E. Comstock to Roger Minott Sherman (Feb. 15, 1806) (on file with Fairfield Museum & Hist. Center).

[100] Sherman's business originated across the state, from Litchfield in the northwest to New London in the southeast. *See* Letter from James Gould to Roger Minott Sherman (Nov. 9, 1805) (on file with Fairfield Museum & Hist. Center); Letter from William Cleaveland to Roger Minott Sherman (Aug. 18 1806) (on file with Fairfield Museum & Hist. Center).

Even as a young lawyer much of Sherman's business originated in New York City. Clients from New York asked him to compile evidence, to make settlement arrangements, to collect debt, and to foreclose on property. *See, e.g.,* Letter from Franklin Robinson to Roger Minott Sherman (July 22, 1802) (on file with Fairfield Museum & Hist. Center); Letter from Franklin Robinson to Roger Minott Sherman (Feb. 7 1806) (on file with Fairfield Museum & Hist. Center); Letter from Thomas Franklin to Roger Minott Sherman (March 8, 1808) (on file with Fairfield Museum & Hist.

who owed them money, they recounted difficulty in tracking down and settling with debtors. Sherman's clients needed him to accurately report on the debtor's circumstances, make an honest effort to collect the debt, engage settlement negotiations, and, if necessary pursue legal action.

Sherman, like many lawyers, was well positioned to do this because he participated in social networks that allowed him to exert pressure on debtors. He worked for and with the most successful businessmen in Fairfield, and he knew them as a leader of his church, as an active member of a local temperance society, and through his involvement in local government, in addition to in his professional capacity.[101] Similarly, the connections Sherman developed at the Litchfield Law School, the most successful early American law school, and in his legal practice placed him within a broad social and professional network. At Litchfield, Sherman learned alongside ten other students, nine of whom went on to become lawyers.[102] In addition to his classmates, Sherman developed connections to other Litchfield alumni, including James Gould, who would later become a judge. He strengthened the connections he established at Litchfield through apprenticeships with prominent lawyers and in practice. Sherman and other lawyers exchanged business letters, referred business, met at court, and visited each other regularly.[103] Anonymous market transaction made social pressure difficult to exert from a distance; by relying on his network, Sherman could exert it more directly. It was easier to avoid a letter from an out-of-state creditor than it was to hide from a well-connected local lawyer's visit.

As a result, even large concerns such as Franklin, Robinson & Co., a well-established trading firm headquartered in New York City, relied on Sherman to collect their debts.[104] Sherman helped Franklin, Robinson, & Co. redeem unpaid debts owed by a local flourmill, obtain evidence in other suits, and settle cases.[105] Although Franklin, Robinson, & Co.'s ships traveled thousands of miles to trade with East Asia, China, and Europe to sell products including pepper, almonds, wine, and gunpowder, Franklin, Robinson, & Co. needed Sherman's expertise and legal

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Center).

[101] *See* WILLIAM A. BEERS, A BIOGRAPHICAL SKETCH OF ROGER MINOTT SHERMAN, THE EMINENT CONNECTICUT JURIST, 1773-1845 at 9-19 (Bridgeport, Conn., J.H. Cogswell 1882).

[102] The lawyers were Elijah Bates, Asa Chapman, William Pitt Cleaveland, Robert Fairchild, Timothy Burt, Jonathan Walter Edwards, Asa Bacon, Ezekiel Bacon, and Elijah Adams. For more on the importance of Litchfield networks see Mark Boonshoft, *The Litchfield Network: Education, Social Capital, and the Rise and Fall of a Political Dynasty*, *1784-1833*, 34 J. EARLY REP. 561, 561-95 (2014).

[103] Oliver Ellsworth, the lawyer who first apprenticed Sherman, for example, continued to correspond with Sherman throughout his career.

[104] *See, e.g.,* Letter from Franklin and Robinson to Roger Minott Sherman (July 22, 1802) A BIOGRAPHICAL SKETCH OF ROGER MINOTT SHERMAN, THE EMINENT CONNECTICUT JURIST, 1773-1845; WALTER BARRETT, 2 *OLD MERCHANTS OF NEW YORK* 247-48 (New York, Carleton 1863).

[105] *See, e.g., id.*; Letter from Franklin and Robinson to Roger Minott Sherman (Feb. 7., 1806) (accepting settlement arrangement).

network to bridge the sixty miles to Fairfield, Connecticut.[106] Even when the collection process was straightforward, Sherman's intervention saved his clients from making time-consuming trips to collect debts.[107]

The note-related work that played a significant part in Sherman's early practice characterized legal work throughout the nineteenth century. It was not until the Civil War that the treasury began to print money under the authority granted to it by the Constitution.[108] Even after the arrival of greenbacks, commercial actors still relied on private financing for many transactions. Lawyers' books from isolated Ohio towns, New York's metropolis, and the South's slave-based economy therefore illustrate the pervasive necessity for collection work.

In Georgia, for example, Eugenius Aristides Nisbet, another lawyer educated at the Litchfield Law School, performed extensive collection work for out-of-state creditors, especially New York City's powerful manufacturers, wholesalers, and importers, who sold their goods to southerners on credit.[109] Like their counterparts active in Connecticut, northern merchants with outstanding debts in South relied on their lawyers to navigate not only legal rules but also the distance that made debt collection difficult. The delegation of authority was often explicitly acknowledged in Nisbet's correspondence. A representative of the Agency People Bank, for example, wrote to Nisbet that he should give their debtor "as much time as [he could] without inconvenience or risk."[110] John S. Martin, another client, wrote to Nisbet's firm, encouraging them "use [its] best judgment" in redeeming a note on its behalf.[111] Similarly, the firm Allen, McLean, & Bulkey expressed the "willingness to accept . . . settlement," but left the specifics up to Nisbet.[112]

When Nisbet, received a note for collection, he rarely sued the debtor immediately. Instead, he investigated a debtor's assets, researched liens on his property, and attempted to compromise or settle.[113] Suits took time, opened the

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[106] *See* BARRETT, *supra* note __ at 247-48.

[107] *See* Letter from Franklin and Robinson to Roger Minott Sherman (July 22, 1802) A BIOGRAPHICAL SKETCH OF ROGER MINOTT SHERMAN, THE EMINENT CONNECTICUT JURIST, 1773-1845; WALTER BARRETT, 2 *OLD MERCHANTS OF NEW YORK* 247-48 (New York, Carleton 1863).

[108] *See* U.S. CONST. art. I, § 8, cl. 5 (permitting Congress to coin money); U.S. CONST. art. I, § 10, cl. 1 (prohibiting states from coining money). For more on the history of money, see MYERS, *supra* note 44, at 163 ("[U]niform paper currency . . . made possible the elimination of the motley array of state bank paper which had so long plagued the economy.").

[109] For information on the power of New York businessmen in the nineteenth century, see SVEN BECKERT, *supra* note 14.

[110] Letter from People Bank to E.A. & J.A. Nisbet (March 18, 1858) (on file with David M Rubenstein Rare Book & Manuscript Libr.).

[111] Letter from John S. Martin to E.A. & J.A. Nisbet (Dec. 31, 1860) (on file with David M Rubenstein Rare Book & Manuscript Libr.).

[112] Letter from Allen, McLean, & Bulkey to E.A. & J.A. Nisbet (Sep. 9, 1859) (on file with David M Rubenstein Rare Book & Manuscript Libr.).

[113] *Id*. Although the advertisement was published after the Civil War, Nisbet's records illustrate that his firm used a similar redemption process in the antebellum period.

door to legal gamesmanship, and did not benefit the creditor if the debtor had no assets to seize. When a "low river and curtailed facilities of Cotton Planters" made it difficult for a debtor to pay his New York creditor, it was Nisbet's job to determine if such excuses were valid, if waiting for a financial return made sense, if the payment plan suggested by the delinquent debtor was acceptable, or if it were better to sue quickly before other creditors did.[114] All of this depended on Nisbet's discretion, expertise, and local knowledge.

Relying on the discretion of lawyers like Nisbet allowed northern merchants to participate in the southern economy without visiting the South and helped them to weather the setbacks of a volatile nineteenth century economy dependent on promissory notes. But this only worked if businessmen were able to trust their lawyers.

2. *Land Sales*

In addition to assisting clients with debt collection, lawyers in nineteenth century America also worked as long-distance land agents, helping eastern speculators to sell land located in the West. There, the problems of transportation and communication experienced in the rest of the country were magnified. Land sales took place in isolated towns, separated from the east by nearly month-long journeys, and slow and unreliable mail service.[115] Absentee landowners could not hope to closely monitor these sales, nor did they sell enough land to justify hiring a full-time employee. Lawyers, however, could work on behalf of several landowners. Out of necessity, clients delegated significant authority to their lawyers, who performed a variety of tasks on their behalf. Lawyers assumed a broad set of agent roles. They drafted mortgages and brought suit, but they also acted as bankers, salesmen, land managers, and accountants. These roles placed lawyers at the center of commercial exchange in the West and helped make land sales at a distance possible.

The work of a land agent lawyer fell into five main categories: management, sales, accounting, litigation, and communication. Each of these categories of work frequently required a lawyer to use his discretion, knowledge, and expertise to make decisions on behalf of his client.

As a land manager, a lawyer looked after his client's holdings. He calculated and paid taxes,[116] organized workers who cleared land or surveyed it for division into smaller parcels,[117] and inspected the land for features that would

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[114] Letter from Trowbridge, Dwight, & Co. to "Gentlemen" (March 9, 1855) (on file with David M Rubenstein Rare Book & Manuscript Libr.). It is unclear whether the Letter was originally addressed to Nisbet's firm or to one of his clients who forwarded it to the firm.

[115] *See supra* notes _____ and accompanying text.

[116] *See* Letter from Elisha Whittlesey to Elisha Sterling (May 2, 1808) (on file with the W. Reserve Historical Soc'y) (noting that if land tax had not been paid the land "would have been exposed for sale"); *see also id.* (explaining complicated tax requirements).

[117] *See* Elisha Whittlesey, Account Book (1806-1817) (on file with the W. Reserve Historical

justify a higher selling price. [118] Lawyers thus decided the appropriate level of taxes to be paid, determined the wages of workers, and used their local knowledge to determine the appropriate value of land.

During land sales, lawyers investigated title,[119] vetted buyers and sellers, prepared sales contracts,[120] transferred deeds, [121] and registered sales with the state.[122] Here too, a client depended on his lawyer's discretion and expertise. *Ex ante*, landowners could not easily anticipate all obstacles to transaction that could arise. Attorneys who misjudged a buyer or seller, carelessly investigated a title, made errors in a mortgage, or improperly registered a deed with the state, might cost their client significant sums of money. *Ex post*, the difficulty, slow speed, and expense of travel meant that landholders would have faced significant difficulty in attempting to evaluate the conduct of their agents. If they wanted to sell land, they had little choice but to trust their lawyer.

As *de facto* accountants, lawyers kept track of a client's place within the web of promissory notes and mortgages that connected buyers and sellers in the West. They advised clients on the likelihood of repayment[123] and worked to secure notes with property.[124] They also sent profits back East.[125] This work relied on a lawyer's financial acumen, judgment, and honesty, which, however, were difficult

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Soc'y) (noting payment of other people on behalf of Elisha Sterling).

[118] Letter from Elisha Sterling to Elisha Whittlesey (May 29, 1820) (on file with the W. Reserve Historical Soc'y) (instructing Whittlesey to examine boundaries of the "Landon Lot"); Letter from Elisha Whittlesey to Elisha Sterling (Oct. 10, 1810) (on file with the W. Reserve Historical Soc'y) (noting that Whittlesey found coal and limestone on the land)..

[119] Letter from Elisha Sterling to Elisha Whittlesey (Oct. 2, 1804) (on file with the W. Reserve Historical Soc'y) (requesting that Whittlesey verify "that the Lot belongs to me and has not been conveyed by myself or Masterman to any other").

[120] *See, e.g.*, *id.* (detailing contract providing for payment from seller to purchaser of $3 per deficient acre if the lot were too small and a payment of $3 per additional acre if the lot were larger than specified).

[121] *See, e.g.*, *id.* ("[I] inclose to you my deed . . . thereby approving of the contract you made with him").

[122] *See, e.g.,* Letter from Elisha Whittlesey to Elisha Sterling (May 2, 1808) (on file with the W. Reserve Historical Soc'y) (listing work of recording a deed in August, 1807).

[123] *See* Letter from Elisha Sterling to Elisha Whittlesey (Oct. 7, 1816) (on file with the W. Reserve Historical Soc'y) (requesting accounting of "what has been paid & what is yet due & the probability of Collection as we have a statement of each Debt we could then determine what would be proper for us to do with Robbins"); *see also* Letter from Elisha Whittlesey to Elisha Sterling (November 17, 1807) (on file with the W. Reserve Historical Soc'y) (listing Sterling's notes and explaining their status).

[124] In one case Whittlesey traveled "forty miles" to visit a sickly debtor and then inspect "three or four thousand acres of forest lands" for "quality of soil and local situation." Letter from Elisha Whittlesey to Elisha Sterling (May 27, 1811) (on file with the W. Reserve Historical Soc'y).

[125] *See* Letter from Elisha Sterling to Elisha Whittlesey (Oct. 2, 1804) (on file with the W. Reserve Historical Soc'y) (requesting that Whittlesey pay debts and send the extra money back East); Letter from Elisha Sterling to Elisha Whittlesey (Aug. 31, 1819) (on file with the W. Reserve Historical Soc'y) (making arrangements for Whittlesey to send money with a neighbor).

for clients to assess. The delegation of authority was so extensive that clients even counted on their lawyers to pay themselves.[126]

Lawyers also handed the fallout when transactions went bad. They negotiated with buyers in default,[127] brought suit,[128] took depositions,[129] and repossessed property.[130] These legal disputes were sometimes long and complicated. Clients depended on their lawyers' legal expertise, settlement skills, judgment, and persistence.

Lawyers not only controlled their clients' money and land, they also governed their access to information about it. Clients relied on their lawyers to provide updates from the West, accounting for and explaining the work their lawyers undertook on their behalf. Surviving letters help explain the scope of a lawyer's work. Some provide detailed accounting activities, listing expenses from payment on a note, investigations of titles, recording of deeds, tax payments, and income.[131] Others provide lists of outstanding notes along with status and likelihood of redemption along with summaries of court judgments and executions.[132] Letters of more modest scope provide updates on individual sales, cases, or notes.[133] These letters demonstrate the extent to which speculators depended on the reliability of their land agents. It would have been easy for a lawyer to lie about the amount of a land sale or note and pocket the difference. Speculators who had never seen their land would have significant difficulty uncovering such deception.

3. *Transactional Support*

Lawyers' services were necessary not only on the periphery of the country but at the center of the nineteenth century American economy: New York City. By 1860, 35 percent of American exports and 64 percent of its imports traveled through

[126] *See* Letter from Elisha Sterling to Elisha Whittlesey (Oct 2, 1804) (on file with the W. Reserve Historical Soc'y) ("I have no doubt that my business is well attended to . . . to take your own Pay as you earn it.").

[127] *See* Letter from Elisha Whittlesey to Ansel Sterling (Mar. 22, 1808) (on file with the W. Reserve Historical Soc'y) (discussing ongoing negotiations with a debtor in default).

[128] *See, e.g.,* Letter from Elisha Whittlesey to Ansel Sterling (Nov. 22, 1808) (on file with the W. Reserve Historical Soc'y) (discussing lawsuit).

[129] *See, e.g.*, Letter from Elisha Sterling to Elisha Whittlesey (Aug. 5, 1813) (on file with the W. Reserve Historical Soc'y) (requesting that Whittlesey take depositions).

[130] *See* Letter from Elisha Whittlesey to Elisha Sterling (Oct. 1, 1809) (on file with the W. Reserve Historical Soc'y) (discussing selling of repossessed land).

[131] Letter from Elisha Whittlesey to Elisha Sterling (May 2, 1808).

[132] Letter from Elisha Whittlesey to Elisha Sterling (Nov. 17, 1807).

[133] *See, e.g.,* Letter from Elisha Whittlesey to Samuel Smedley (Apr. 21, 1812) (on file with the W. Reserve Historical Soc'y) (discussing land auditor errors); *See* Letter from Elisha Whittlesey to Ansel Sterling (Mar. 22, 1808) (on file with the W. Reserve Historical Soc'y) (discussing ongoing negotiations with a debtor in default). Letter from Elisha Whittlesey to Elisha Sterling (July 3, 1809) (on file with the W. Reserve Historical Soc'y) (discussing mortgage holder who claims to have paid off his land).

New York's harbor.[134] New York manufacturers, bankers, traders, merchants, and insurers relied on lawyers to help them expand their businesses and secure their city's place as a major site for world commerce.[135] As in the rest of the country, this work depended on lawyer's legal expertise and local knowledge, and it demanded a significant delegation of authority and discretion. Working with relatively little direct oversight, New York lawyers helped their clients collect debts, speculate on land, develop the insurance industry, and engage in national and international trade.

Even in the middle of the nineteenth century, the dearth of specie meant that New York businesses relied on private financial instruments for trade. As in the rest of the country, lawyers in New York played an important part in note-based exchange. Lawyers drafted securities,[136] negotiated with debtors,[137] filed legal protests, and secured property as collateral for loans.[138] In addition to helping their clients redeem debts directly, lawyers also managed long-distance collection efforts. They found lawyers in remote locales, sent them notes for redemption, and handled money when it was collected.[139]

Thus, in New York, as in the rest of the country, the financial work that lawyers undertook required that their clients delegate authority and discretion. Because clients could not closely monitor their lawyers, the potential for self-dealing was significant.

As in Ohio, real estate speculation was rampant in New York City. In New York, however, lawyers worked less as salesmen and land managers and more as navigators of the complex legal rules of property that surrounded transaction. Clients relied on their lawyers to draft instruments of transactions, prepare mortgages, write leases,[140] and draft deeds.[141] In addition, lawyers investigated

[134] William Pencak, *Introduction*, *in* NEW YORK AND THE RISE OF AMERICAN CAPITALISM: ECONOMIC DEVELOPMENT AND THE SOCIAL AND POLITICAL HISTORY OF AN AMERICAN STATE, 1780-1870, at xii (William Pencak & Conrad Edick Wright eds., 1989).

[135] *See generally*, BECKERT, *supra* note 14; NEW YORK AND THE RISE OF AMERICAN CAPITALISM, *supra* note 134.

[136] *See, e.g.*, Daniel Lord, Ledger (1815-1823) (on file with John D. Gordon III) ("[t]o services in securing debt of Richardson" and "drawing securities with Rich & Grant").

[137] *See, e.g.*, *id.* ("protesting note" on behalf of Aiken, Fisher, and Goddard).

[138] *See, e.g.*, *id.* ("Services in securing debts of Richardson" on behalf of John Penfold).

[139] *See, e.g.,* Letter from Ward, Jackson, & Jones to E.A. & J.A. Nisbet (Oct. 14, 1859) (on file with David M Rubenstein Rare Book & Manuscript Libr.) (writing on behalf of their clients, the Planter's Bank of Savanah, Georgia); Letter from Will Varnum to E.A. Nisbet (July 4, 1857) (on file with David M Rubenstein Rare Book & Manuscript Libr.); Letter from Brown & Sully to E.A. & J.A. Nisbet (Jan. 25, 1868) (on file with David M Rubenstein Rare Book & Manuscript Libr.) (requesting investigatory work related to Iowa estate); Letter from S. Hunt to Judge Nisbet (May 21, 1860) (on file with David M Rubenstein Rare Book & Manuscript Libr.).

[140] *Id.* (drawing trust deed and drawing "party wall agreements" and "agreements of lease").

[141] Daniel Lord, Ledger (1815-1823) (on file with John D. Gordon III); *Id.* (noting work done on behalf of Benjamin Birdsall).

complicated title histories in order to ensure that the buyer actually owned the land he purported to sell and that later sales would not be encumbered by title disputes. A lawyer's title research book reveals extensive examinations of the provenance of land, including detailed descriptions (and sometimes maps) of it borders, long histories of its transmission, and a report on liens, unsatisfied judgments and other legal clouds on the title.[142] Beyond legal advice, lawyers also sometimes helped their clients to negotiate sales.[143]

Because drafting and title search work depended on legal expertise, they also depended on the delegation of discretion. Clients lacked the training to assess their agent's legal knowledge before hiring them. The same lack of legal expertise made it difficult to evaluate an agent's work after it was completed.

In the nineteenth century, insurance developed as an important industry in New York, providing a way for those active in commerce to manage its risks. For insurers and the insured, lawyers interpreted policies, drafted affidavits testifying to the value of goods,[144] and provided reputation in court for policy disputes.[145] Clients thus relied on lawyers to ensure that the policies that they bought and sold insured against the risks that they expected. Because they demanded legal expertise to interpret, clients were reliant on their lawyers, delegating discretion to them to draft and take out policies that covered both expected and unexpected events.

For traders and merchants, lawyers were equally important. Lawyers not only served as agents but also prepared power-of-attorney forms, which authorized others to act as agents on behalf of their clients. These forms sometimes gave agents generalized powers; other times they limited agent power to specific purchases or sales of land, goods, or stock.[146] In addition, lawyers prepared and reviewed contracts for sales and provided advice to clients engaged in transaction.[147] Finally, lawyers helped their clients regulate their internal affairs by

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[142] *See* Grant Morrison, *A New York City Creditor and His Upstate Debtors: Issac Bronson's Moneylending, 1819-1836*, 61 N.Y. HIST. 255, 267-268 (1980) (describing importance of title searches). Titles were complicated before lawyers became involved. *See, e.g.,* David Thomas Konig, *Community Custom and the Common Law: Social Change and the Development of Land Law in Seventeenth-Century Massachusetts*, 18 AM. J. LEGAL. HIST. 137, 148, 163 (1974) (discussing problems caused by uncertain titles including the reduction of land values).

[143] Daniel Lord, Ledger (1815-1823) (on file with John D. Gordon III) (on behalf of S B. J. Morse).

[144] *See* Daniel Lord, Ledger (1815-1823) (on file with John D. Gordon III).

[145] In one of his first cases of great prominence, he argued that rats eating bear skins fell under an insurance clause that covered "perils of the sea." MEMORIAL, *supra* note 18, at 15.

[146] *See* Daniel Lord, Ledger (1815-1823) (on file with John D. Gordon III).

[147] *See, e.g.*, *id.* (listing the drawing of an agreement and a bill sale, as well as charges for "advice & services purchasing order & memorandum for silk goods"); *Id.* (listing $1 charge for "examining agreement with J. J. Astor).

drafting articles of co-partnership and corporate charters, and by giving advice on the law of corporations.[148]

In sum, in a market defined by volatility, risk, arms-length transaction, and legal governance, lawyers were an essential part. In New York, as in Connecticut, Georgia, and Ohio, lawyers played major roles in the most active sectors of the nation's economy. Clients delegated significant power to their lawyers and depended on their expertise and knowledge when undertaking transactions.

All of this activity depended on a lawyer's legal expertise, expertise that his client was unlikely to share. A lawyer's advantage in expertise—and the authority delegated to him by his client—created opportunities for corrupt behavior. He could take advantage of financial opportunities initially offered to his clients, accept bribes to prepare documents that gave advantage to his client's trading partners, or work with unscrupulous agents to take advantage of a broadly drafted power-of-attorney form.

In order to achieve their prominent roles as commercial agents, lawyers therefore had to establish their trustworthiness in an economic climate rife with fraud. The profession succeeded by professing adherence to fiduciary principles.

V. THE CONSTRUCTION OF PROFESSIONAL IDENTITY

American lawyers relied on fiduciary principles to build and disseminate an image of the profession as trusted agents. The principles appeared in honorary speeches, obituaries, and ethical manuals and made fidelity to clients the ethical core of nineteenth century practice. Principles of trust dated back to the medieval period. But their development and diffusion in the nineteenth century – not least as principles of attorney conduct – offered a highly efficient institutional answer to the severe agency problems that might have undermined the transition to capitalism.

A. Development of the Law of Fiduciaries

The law of fiduciaries can be traced back to late medieval law of trusts that were enforced in the Court of Chancery in England.

The Court of Chancery governed the late medieval practice of entrusting land to another person, the *feoffment of uses*, to avoid the reversion, upon death, of the land to the Crown.[149] Land could be held only by certain (male) members of the aristocracy under the common law. Thus, to secure land for the benefit of others, the land would be conveyed to a trustee, who would hold the property as an

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[148] *Id.*; Daniel Lord, Daybook (1837-1838) (on file with John D. Gordon III).
[149] *Id.*

owner, for use by designated beneficiaries.[150] The English Chancery recognized the feoffment of uses and enforced certain rights of beneficiaries against abuse by trustees as a breach of trust, or confidence.

By the eighteenth century, breach of trust or confidence covered "a good deal more ground than trusts of property."[151] Breach of trust or confidence was applied in many different contexts by the eighteenth, and early nineteenth century.[152]

> A was said to have confidence reposed in him by B not only where B had entrusted A with property to hold and deal with on behalf of himself or others – as in the trust strictly so called – but also where A undertook to exercise a power, to conduct a sale, to supervise an estate or business, or in some other way to become B's employee or agent. Confidence was also reposed where B was dependent on A's advice, perhaps because A was a professional advisor or expert, or more familiar with the subject-matter; because A was on the spot and B at a distance; or because A was a trusted servant or friend or a person of dominant character or position who was able to influence B's decisions. [153]

In all these cases, courts of equity were competent to afford relief. They exercised broad discretion and deployed a "simple legal vocabulary relying on general words such as 'trust' and 'confidence'."[154] By the beginning of the nineteenth century, broad discretion and the simple legal vocabulary gave way to more concrete rules, and a standard technical vocabulary began to develop.[155]

The term "fiduciary" gained currency in the law reports towards the mid-nineteenth century as a term descriptive of relationships that were recognized by the law as "relationships of trust" but which needed to be distinguished from actual trust law, because of the latter's increasingly more technical meaning.[156] In his 1846 treaty on equity jurisprudence, Joseph Story's listing of relationships with "fiduciary ties" included those between "Client and Attorney, Principal and Agent, Principal and Surety, Landlord and Tenant, Parent and Child, Guardian and Ward, Ancestor and Heir, Husband and Wife, Trustee and Cestui Que Trust, Executors or Administrators and Creditors, Legatees, or Distributees, Appointor and Appointee under powers, and Partners, and Partowners."[157]

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[150] W.S. Holdsworth, *The English Trust: Its Origins and Influence in English Law*, 4 L. HIST. R. 378 (1923) ("The denial of all proprietary capacity to the married woman by the common law was remedied by the invention of property vested in trustees to her separate use. Over this property she was gradually given a complete power of disposition.")

[151] P.D. FINN, FIDUCIARY OBLIGATIONS __ (1977)

[152] L.S. Sealy, *Fiduciary Relationships*, 20 CAMBRIDGE L.J. 69, 69 (1962).

[153] *Id*. at 69.

[154] *Id.* at 70.

[155] FINN, *supra* note 151, at 4; *see also* Sealy *supra* note 152, at 72.

[156] Sealy, *supra* note 152.

[157] JOSEPH STORY, 1 COMMENTARIES ON EQUITY JURISPRUDENCE: AS ADMINISTERED IN ENGLAND AND AMERICA 242 (Boston, Little & Brown 1846).

Such relationships, Story noted, came to be governed by the "general principle" that "if a confidence is reposed, and that confidence is abused, Courts of Equity will grant relief."[158] As Story explained, Courts of Equity did not impose a general morality on commercial activity.[159] They did not vindicate expectations of honesty, trust, or fairness in contractual relationships in general.[160] Equity instead imposed certain fundamental obligations only in relationships that it defined as relationships of trust or confidence, in which one person acquired "influence" or "control" over another person, their property, or their rights. Story described these obligations as "a technical morality" that applied specifically and exclusively to trusted agents:

> [Courts of Equity]…do not sit, or affect to sit, in judgment upon cases, as *custodies morum*, enforcing the strict rules of morality. But they do sit to enforce, what has not inaptly been called, a technical morality. If confidence is reposed, it must be faithfully acted upon, and preserved from any intermixture of imposition. If influence is acquired, it must be kept free from the taint of selfish interests, and cunning, and overreaching bargains. If the means of personal control are given, they must be always restrained to purposes of good faith and personal good. Courts of Equity will not, therefore, arrest, or set aside, an act or contract, merely because a man of more honor would not have entered it. There must be some relation between the parties, which compels the one to make full discovery to the other, or to abstain from all selfish projects. But, when such a relation does exist, Courts of Equity, acting upon this superinduced ground, in aid of general morals, will not suffer one party, standing in a situation, of which he can avail himself against the other, to derive advantage from that circumstance.[161]

When acting on behalf of another, the fiduciary was required to act honestly and in good faith, set aside self-interest entirely, and act solely in the interests ("personal good") of the other. The fiduciary could not personally profit or take advantage of the trust reposed, unless the circumstances were fully disclosed to, and approved by, the fiduciary. In policing fiduciary relationships, courts would look for any "taint" of "selfish interests", "cunning", or "overreaching bargains", and jealously protect the beneficiary from an abuse of trust.

The fiduciary relationship came to be defined in law and practice as a relationship of trust or confidence in which one person – the fiduciary – has been entrusted with the power or authority of making decisions that affect the property or the legal relations of another. Equity demanded that fiduciaries (1) follow and abide by the directives of the entrustment, (2) act exclusively in the best interests of the principal or beneficiary, (3) act in good faith in performing fiduciary services,

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[158] *Id.* at 327.

[159] It should be noted, however, that Story's views were not always shared, and that Story was intent on reigning equity in.

[160] *See, e.g.,* LAWRENCE, *supra* note 25, at 456 ("The various affairs of life in almost every act between individuals in trade and commerce involve the reposing of confidence or trust in each other, and yet it has never been supposed that because such confidence and trust in the integrity of another has been extended and abused that therefore a court of equity in all such cases assumes jurisdiction.").

[161] STORY, *supra* note 157, at 327.

(4) provide account and disclose relevant information to the principal or beneficiary, (5) refrain from delegating the fiduciary services to others, and (6) treat beneficiaries "fairly," in case there were more than one beneficiary.[162]

In part because it emerged from the moral vocabulary of equity, fiduciary law propagated norms of trust in commercial relationships. A breach of fiduciary duty carried a special moral condemnation with it. And the moral language of the courts clearly reflects that courts sitting in equity considered norm-making as part of their function. This role of norm-making was self-consciously espoused by the Chancery. Henry Home, for example, articulates the reasoning behind the prophylactic no-profit rule in the case of a guardian:

> But equity goes farther, and prohibits a trustee from making any profit by his management, directly or indirectly. However innocent an act of this nature may be in itself, it is poisonous with regard to its consequences; for if any opportunity be given for making profit in this manner, a trustee will lose sight of his duty, and soon learn to direct his management chiefly or solely for his own profit. It is solely upon this foundation that a tutor [guardian] is barred from making profit by purchasing debts due by his pupil [ward], or rights affecting his estate ….[163]

This reasoning constitutes an analysis of what it takes to school a trustee in trustworthy conduct towards a beneficiary. The clear purpose of the no-profit rule is to establish a habit of mind. The purpose here, as in Story's account of equity's "technical morality" cited above, is to condition agents to engage in self-abnegation and assume the role of acting in the sole interests of another. [164]

B. Professional Ethos

Lawyers were educated in the emerging law of fiduciaries. And elite lawyers embraced fiduciary principles and the self-abnegation that such principles demanded in defining their role as agents. The expression of fiduciary ethos in the legal profession took a variety of forms and was not always explicit, but lawyers consistently placed integrity and fidelity in service to clients at the core of their professional vision. They self-consciously distinguished their role as professionals in social and economic life from that of self-interested market participants. Fiduciary principles that lawyers first disseminated in biographies and obituaries eventually made their way into ethical manuals that formalized the standards of professional practice.

Throughout the nineteenth century, lawyers across the country honored their colleagues with resolutions at bar meetings and published portraits in legal

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[162] Frankel, *supra* note 25, at 106-7.

[163] LORD KAMES (HENRY HOME), PRINCIPLES OF EQUITY 108, 255 (Edinburgh, Kincaid & Bell, 2d. Ed. 1767).

[164] Lord Kames' PRINCIPLES OF EQUITY, not quite incidentally perhaps, enjoyed considerable influence in the United States. Robert G. Natelson, *The Constitution of Public Trust*, 52 BUFF. L. REV. 1126 n.207 (2004).

magazines, case reports, and books. For lawyers in the nineteenth century, the laudatory biography or obituary served as a useful way to transmit professional values. As one major biographer of lawyers put it, biography served as "Philosophy Teaching by Example."[165]

Profiles of lawyers present a consistent picture of a profession devoted to client service. The Connecticut Bar, for example, established a well-honed professional image in the honorary portraits it included in the CONNECTICUT REPORTS. In profile after profile, lawyers praised their colleagues for their intelligence, deep knowledge of the law, strong work ethic, and treatment of clients and colleagues with respect and honesty.[166] The proper treatment of clients, however, was especially emphasized. Lawyers praised their colleagues for their "honorable and high-minded . . . management of . . . cases" and for the "purity of character" they demonstrated when interacting with clients.[167] A good lawyer was not only "courteous" to his client but also held himself to the highest standards of "integrity" when undertaking his clients' business.[168] In a word, "fidelity" was at the core of legal practice.[169] Although not explicitly tied to the law of fiduciary duty, the language of fiduciary service permeated the way Connecticut lawyers thought about legal practice.

In New York, elite lawyers similarly praised their most respected colleagues for remaining above the fray of a commercial market dominated by acquisitive values and for serving their clients with fidelity. For these men, "the profession of the law was not in and of itself the pursuit of gain."[170] A good lawyer worked hard not for his own benefit but to benefit his client. He pursued his clients' ends diligently, "as if work was all that there was of life that was worthy to be done," and he did so at rates that were "proportioned to the service he performed in every case."[171] The best lawyers, in other words, were so devoted to their clients' interests and so appalled by self-serving behavior that they did not even charge as much as they could have.[172]

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[165] 2 & 3 BIOGRAPHICAL SKETCHES OF EMINENT LAWYERS, NOW LIVING (John Livingston ed., New York, 1850). Also see M.H. Hoeflich's analysis in LEGAL PUBLISHING IN AMERICA 157 (2010).

[166] *See Francis Parsons*, 29 CONN. 604-06 (1861); *Samuel Johnson Hitchcock*, 17 CONN. 50-51 (1845); *Jonathan Walter Edwards*, 15 CONN. APP. R. 26-28 (1842); *Sketch of the Life and Character of the Hon. David Daggett*, 20 CONN. 7-20 (1849); *Roger S. Baldwin*, CONN. 609-13 (1862).

[167] *Id.*

[168] *Id.*

[169] *Id.*

[170] William Evarts, *Speech*, *in* MEMORIAL OF DANIEL LORD, *supra*, note 18, at 74-75.

[171] *Id.* at 69.

[172] Thus, a good lawyer continued to practice even if he became wealthy, because client service not pay was his primary motivation. *See* MEMORIAL OF DANIEL LORD*, supra* note 18*,* at12 (noting that Lord "did not suffer the withdrawal of the absolute necessity for work to check the ardor with which he continued his accustomed labor").

John Livingston's edited collection of legal biographies demonstrates respect for similar values. The biographies praise lawyers for their "industry and strict attention to the business of his clients"[173] and for their demonstration of the "highest integrity."[174] A good lawyer "appreciate[ed]" the "sacred duty" of loyalty and faithfulness he "owed his client."[175] He not only performed his work with diligence and skill but also "identifie[d] with his client,"[176] "forget[ting] himself and his own interest in his cause, and devot[ing] his utmost energies for the success of his client."[177] In short, a good lawyer had the "duty" to exhaust "any honorable means . . . to secure and advance [his client's] interests."[178]

Livingston's book emphasized the same fiduciary duties of loyalty, disinterestedness, and integrity identified by elite lawyers in Connecticut and New York as the core of their professional ethos. In this ethical framework, self-serving behavior had no place. Instead, the "integrity of purpose and fidelity to his client," qualities that one of Livingston's biographers understood as "not unusual in the profession," were the central tenets of a profession in which lawyers defined themselves as the trusted agents.[179]

In 1854, George Sharswood, a lecturer at the University of Pennsylvania distilled this fiduciary ethos in A COMPEND OF LECTURES ON THE AIMS AND DUTIES OF THE PROFESSION OF LAW.[180] The essay, based on lectures he gave his students, was the most popular manual on legal ethics in the United States. Subsequently published as AN ESSAY ON PROFESSIONAL ETHICS, it went through four editions in twenty-two years.[181] One Georgia lawyer, who read Sharswood's "Little Book" soon after it was published, captured the profession's enthusiasm: the book, he concluded, was "pure gold" and it deserved to "be read by every Lawyer in the Union."[182]

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[173] *Hon. George H. Gordon*, *in* 4 BIOGRAPHICAL SKETCHES OF EMINENT LAWYERS, NOW LIVING 673, 675 (John Livingston ed., New York 1852).

[174] *Id.* at 643. *See also Hon Z Wheat*, *in* 1 BIOGRAPHICAL SKETCHES OF EMINENT LAWYERS, NOW LIVING (John Livingston, ed. 1852) 139, 141 (praising lawyer for his "*industry, strict attention and perseverance in business, and high integrity*, combined with a strict and vigorous intellect" and "determination to honor the profession").

[175] *David Paul Brown*, *in* 2&3 BIOGRAPHICAL SKETCHES OF EMINENT LAWYERS, NOW LIVING, *supra* note 165, at 178, 198.

[176] *Id.*

[177] *Hon Gilbert Dean, in id.* at 314, 315; *see also Hon. George H. supra* note 173 at 675 ("As an advocate, he is faithful and prompt in his attendance to all business entrusted to his care, and enlists in the cause of his client with as much zeal and earnestness as his own.").

[178] *Hon. John C. Humphreys*, *in* 1 BIOGRAPHICAL SKETCHES OF EMINENT LAWYERS, NOW LIVING, *supra* note 174, at 115, 117.

[179] *Hon. Robert C. Grier*, *in id.* at 44.

[180] GEORGE SHARSWOOD, A COMPEND OF LECTURES ON THE AIMS AND DUTIES OF THE PROFESSION OF LAW (Philadelphia, T. & J.W. Johnson & Co. 1854).

[181] *See* GEORGE SHARSWOOD, AN ESSAY ON PROFESSIONAL ETHICS (4th ed, Philadelphia, T. & J.W. Johnson & Co. 1876).

[182] E.A. Nisbet, Diary (Dec. 15, 1854) (on file with David M Rubenstein Rare Book &

Like his colleagues, who identified intelligence, knowledge of the law, hard work, and diligent service for clients as essential to legal practice, Sharswood wrote that a good lawyer needed to demonstrate "real learning," "the strictist integrity and honor," and "attention, accuracy, and punctuality, in the transaction of business."[183] Like his fellow lawyers, however, Sharswood was most concerned with the obligations a lawyer owed his client. Sharswood recognized that lawyers faced many opportunities for fraud and deceit. "There is . . . no profession," he wrote "in which so many temptations beset the path to swerve from the line of strict duty and propriety."[184] Because of these "pitfalls and man-traps at every step . . . prudence and self-denial as well as . . . moral courage" were needed by every lawyer. "High moral principle," Sharswood continued, "was [a lawyer's] only safe guide."[185]

Sharswood outlined the precepts of these moral principles using terms shared with fiduciary law. In his words, "immovable fidelity" was "the great duty which the counsel owes to his client."[186] "Every consideration," he continued "should induce an honest and honorable man to regard himself, as far as the cause is concerned, as completely identified with his client."[187] This meant not only undertaking work with honesty and integrity but also entailed "[e]ntire devotion to the interest of the client [and] warm zeal in the maintenance and defense of his rights."[188] Thus, the worst thing that a lawyer could do in Sharswood's opinion was to "allow[] himself to be approached corruptly," to be bribed or coerced into doing something that benefited himself at the expense of his client.[189]

For Sharswood, as for his colleagues, self-interested or opportunistic behavior was anathema to the legal profession. Concern with "money-making" was an insult lobbed at those Sharswood accused of "pettifogging."[190] To be successful, a lawyer's character needed to be "not only without a stain, but without suspicion."[191]

By the 1870s, the application of fiduciary principles to attorneys became part of a body of the law of lawyering. Edward P. Week's TREATISE ON ATTORNEYS AND COUNSELLORS OF LAW (1873), lays out a host of obligations that attorneys owed their clients. An attorney hired to draw deeds could not buy the land for himself.[192] Attorneys were obligated to "faithfully pay over to [their] client money

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Manuscript Libr.).

[183] SHARSWOOD, *supra* note 180 at 55.

[184] *Id.* at 9.

[185] *Id.*

[186] *Id.* at 50.

[187] *Id.*

[188] *Id.* at 22-24.

[189] *Id.* at 50.

[190] *Id.* at 80.

[191] *Id*. at 95.

[192] EDWARD P. WEEKS, TREATISE ON ATTORNEYS AND COUNSELLORS OF LAW § 258 (1873).

received on his behalf."[193] They had a duty to investigate the history and "nature of the accounts" when involved in the settlement of an "intricate transaction."[194] They were required to carefully read titles and to "carefully examine every deed or instrument constituting or affecting the title" when assisting with the purchase of land.[195] Transactions between attorney and client were "carefully and jealously regarded, particularly by courts of equity."[196] Such protection extended not just to "conveyances and contracts" but also to gifts from clients, which would be looked at skeptically by courts.[197] Moreover, attorneys could "not in any way whatever . . . make gain or profit for himself at the expense of his client, beyond the amount of his just and fair professional remuneration."[198] Even in the absence of bad faith, courts barred them from purchasing land at sales on which they had consulted for their client, nor could they purchase land at an auction on which they had issued an execution, unless they had explicit consent from their client.[199] Even "extortionate" fee arrangements ran afoul of the courts' zealous protection of the attorney-client relationship.[200] Attorneys also had to provide full and accurate accounting to any transactions they entered into on a client's behalf. Courts were willing to open accounts "settled for many years" in order to punish an attorney accused of taking "unfair advantage of his client's confidence."[201]

In sum, "[t]he highest degree of fairness and of good faith[was] required from an attorney, and the courts . . . closely and jealously scrutinize[d] the dealings between attorneys and their clients, and . . . relieve[d] the matter from any undue consequence resulting from them, whenever the good faith of the contract does not clearly appear."[202]

The claims of purity and devotion to client service from nineteenth century lawyers tend to generate skepticism in modern readers. Even in the nineteenth century, the American public circulated lawyer jokes that accused the profession of many of the vices—fraud, overcharging, deceit, self-interested behavior—that elite lawyers took such pains to condemn.[203] Such jokes might reflect as much on the anxieties that arise from the agency problem as they do on lawyers themselves. This anxiety also translated into efforts by middle-class reformers to limit the profession's influence.[204] We do not deny that corrupt lawyers existed, nor do we

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[193] *Id.* § 264.
[194] *Id.* § 254 n.4.
[195] *Id.* § 267.
[196] *Id.* § 268.
[197] *Id.*
[198] *Id.* § 271.
[199] *Id.* § 274.
[200] *Id.* § 276.
[201] *Id.* § 282
[202] *Id.* § 258.
[203] *See* MARC GALANTER, LOWERING THE BAR: LAWYER JOKES AND LEGAL CULTURE (2005).
[204] These efforts were largely unsuccessful. *See* MAXWELL BLOOMFIELD, AMERICAN LAWYERS IN A CHANGING SOCIETY 44-58 (1976); Maxwell Bloomfield, *Lawyers and Public Criticism:*

claim that lawyers never took advantage of the discretion and judgment delegated to them by their clients. Indeed, even the leaders of the bar admitted that pettifoggers and dishonest lawyers threatened the reputation of their profession.

We argue, however, that commercial lawyers as a profession followed fiduciary norms enough of the time, to build the necessary trust that would encourage clients to rely on them and to participate in markets they would otherwise shun. And these norms were reinforced by the courts. Moreover, lawyers actively promulgated these norms as part of a professional identity that emphasized their ability to facilitate market exchange while remaining above the fray of a risky market.

VI. The Agency Problem and the Fiduciary Response

Based on our empirical investigation of the role of attorneys as trusted agents in the nineteenth century economy, it thus appears that the fiduciary laws and norms made an important contribution to addressing the significant agency problems that prevailed during this period of social and economic transition.

Fiduciary law did so in two ways. First by deterring self-interested, opportunistic conduct. Secondly, by helping to define an emerging social role. Institutional economists recognize the first, but do not consider the second, because their theoretical, contractual approach abstracts from the normative content of fiduciary law and redescribes social relations in terms of self-interested conduct.[205]

A. Doctrine

Fiduciary law is distinctive from contract.

It was even more distinctive in the nineteenth century and before "equity conquered common law" with the discovery revolution under the 1937 Federal Rules of Civil Procedure.[206] Equity courts had special procedural powers to investigate wrongdoing. In contrast with common law courts at the time, Courts of Equity could obtain information otherwise unavailable from defendants and other interested parties, by deposing them under oath and demanding documents.[207]

Challenge and Response in Nineteenth Century America, 15 AM. J. LEGAL HIST. 269 (1971).

[205] Scott Fitzgibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303 (1999).

[206] Stephen N. Subrin, *How Equity Conquered Common Law: The Federal Rules of Civil Procedure in Historical Perspective*, 135 U. PA. L. REV. 909 (1987).

[207] William Paley's treatise on agency concluded: "where the accounts are intricate and difficult, a bill in equity is the more usual and suitable proceeding, to compel an accounting; being best calculated to do justice between the parties, since the plaintiff can thereby obtain a discovery of books and papers, and have the benefit of defendant's oath…" WILLIAM PALEY, A TREATISE ON THE LAW OF PRINCIPAL AND AGENT: CHIEFLY WITH REFERENCE TO MERCANTILE TRANSACTIONS 57

Such discovery was unavailable in common law courts, and is, for the most part, expressly prohibited under civil law.[208] Whereas U.S. attorneys take party on party discovery for granted today, these procedures of information production are unique to U.S. civil adjudication and developed out of the equitable powers of the chancery courts.[209]

Courts sitting in equity had the power to impose much more severe remedies in cases of fraud, deceit, or abuse of confidence. Contract remedies at common law were limited to monetary damages, typically calculated based on the parties' expectations. Expectation damages, as economists point out, allow or encourage efficient breach. Remedies for breach of fiduciary duty, however, consisted of restitution, which could include the disgorgement of any profits that a fiduciary obtained while acting on behalf of a beneficiary. This discouraged any breach.[210] So too did the remedies of constructive trust and "the sometimes extreme rules of tracing" that gave beneficiaries every benefit of the doubt.[211]

The intentions of the parties are central to contract. When judges examine breaches of fiduciary duty, however, they do not look to the parties' intent. Rather they act paternalistically in imposing rules of fiduciary conduct on the parties.[212] The core principles of fiduciary duty cannot be contracted around or treated as default provisions.

The fiduciary analysis, moreover, does not turn on the parties' intentions at the time of contracting, but "constitutes a 'free-floating' duty applied at the time of the wrong."[213] The analysis of the wrong at the time of the injury, and the open-ended nature of the judicial inquiry into potential wrongdoing by a principal, require the fiduciary "to engage her independent judgment (concerning her beneficiary's interests) as she discharges her fiduciary duties."[214] Fiduciaries, and the judges who police fiduciary relationships, thus assume a different "deliberative posture" than the one that governs contract.[215] When acting as a fiduciary on a particular matter, the fiduciary is expected to exercise his judgment as to what under the present circumstances would be in the best interests of the beneficiary and

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(2d. ed., London, Butterworth & Son 1819).

[208] *See*, Michael Halberstam, *American Advantage in Civil Procedure: An Autopsy of the Deutsche Telekom Litigation*, 48 CONN. L. REV. 817 (2016).

[209] Subrin, *supra* note 206, at 206.

[210] Economists thus consider fiduciary rules to be inefficient insofar as they interfere with the maximization of joint welfare by contracting parties.

[211] Henry Smith*, Equity as Second-Order Law: The Problem of Opportunism* 44-45 (Harvard Harvard Pub. L., Working Paper No. 15-13, 2015), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2617413*.

[212] Markovits, *supra* note 21; Deborah DeMott, *The Fiduciary Character of Agency and the Interpretation of Instructions*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 19, at 321.

[213] Markovits, *supra* note 21, at 7.

[214] *Id.*

[215] Markovits, *supra* note 21, at 1.

cannot rely solely on the instructions received from the beneficiary at the time of contracting.

One might imagine different rules of agency that demand less of the agent. Thus, for example, the agency relationship might be defined primarily by the duty to follow the instructions of the principal. Here the role or interpretive process of the agent would be different.[216] The agent's role here would be to look towards the intention of the principal *ex ante* at the time of contracting, rather than to the agent's informed judgment as to the best interests of the principal under current, and perhaps changed, circumstances.[217]

B. Anti-Opportunism

Fiduciary law directly addresses the problems of information asymmetry and opportunism in agency relationships. It is a "technical morality" that articulates rules to reign in "self-interest, cunning, and overreaching bargains," which might be considered the excesses of a commercial culture.[218] As Story explained, "if a confidence is reposed, and that confidence is abused, Courts of Equity will grant relief."[219]

Because it is costly, if not impossible, for principals to specify how their agents should behave in all circumstances, *ex ante* rules cannot prevent agents intent on acting opportunistically from doing so.[220] Fiduciary law discourages opportunistic behavior because a fiduciary's behavior is not judged by whether he followed the intentions of the beneficiary but rather by whether he properly used his independent judgment in the beneficiary's interests. This is a standard that is applied *ex post* by the exercise of judicial discretion. The open-endedness of the standard allows judges to target strategic behavior.[221] And it protects against "hard-to-foresee ways of engaging in opportunism."[222]

The implementation of this open-ended judicial standard is guided by prophylactic rules that target likely indicators and strategies of opportunistic conduct. The duty of loyalty is thus elaborated by the duty not to profit directly or indirectly from the agency relationship without full disclosure, the duty to avoid or disclose conflicts, the duty to give an accounting, and the duty to disclose relevant information. These rules serve as proxies for loyal conduct. Together with the

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[216] *See, e.g.*, DeMott, *supra* note 19, at 321 ("The agent's fiduciary duty to the principal furnishes a benchmark for interpretation and for assessing actions the agent takes in response.").

[217] Markovits, *supra* note 21.

[218] Equity's doctrine of confidence also appears to address what other economists have called "moral hazard."

[219] STORY, *supra* note 157, at 327.

[220] Smith, *supra* note 211, at 14.

[221] Henry E. Smith, *Why Fiduciary Law is Equitable*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 19, at 261, 262.

[222] *Id.*, at 265.

procedural rules of equity, they force the production of information. They thereby address the problem of asymmetric information in the agency relationship that affords the opportunity for abuse.

In this way, contractarians are not wrong in describing fiduciary law as a deterrent to opportunistic conduct. But as Williamson, and economists more generally, recognize, deterrence takes place at the margins.

C. Normative Significance, Reflective Judgment, and Production of Trust

Fiduciary law, we suggest, did not work primarily by deterrence, but by establishing a social role that changed the cognitive orientation of agents and produced trust.[223] In so doing, it offered a solution to the agency problem that has not been sufficiently taken into account by institutional economists.

Fiduciary law articulated a positive principle of conduct, which explicitly demands that the agent take up a particular "moral stance" with regard to the principal. The fiduciary principle requires that the agent distance himself from his own self-interest and reflect, at all times, upon what would, under the circumstances, be in the best interests of another.[224] The moral language used by the courts, the special opprobrium attached to breaches of fiduciary duty, and judicial reflection on what it takes to school fiduciaries to act in the interests of a beneficiary, all remain unexplained, if this social constructive aspiration of fiduciary law is not appreciated.

During the nineteenth century, at a crucial stage in the development of American capitalism, attorneys adopted this moral stance with regard to their clients. To the extent that attorneys did set self-interest aside, and followed fiduciary principles and rules, they exercised their judgment differently and they became more trustworthy. And to the extent they did so, their value as agents increased dramatically.

Trust, as economists have recognized trust, is the most efficient mechanism for governing transactions.[225] Even Williamson implicitly agrees that trust plays a significant role in economic exchange: "[M]ost economic agents are not engaged in opportunistic practices most of the time. That opportunism does not continuously intrude is partly because many economic agents are well-

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[223] For a similar analysis from a behavioral economics perspective, see Blair & Stout, *supra* note 78.

[224] The particular "moral stance" of the agent does not comport with a generalized morality, because it requires the agent to pursue the interests of his principal to the extent that is legally permissible even if such interests conflict with ordinary morality. *See, e.g.*, Richard Wasserstrom, *Attorneys as Professionals: Some Moral Issues*, 5 HUMAN RTS. 1, 2-24 (1975).

[225] Lynn G. Zucker, *Production of Trust: Institutional Sources of Economic Structure, 1840 to 1920*, at 5 (U. Cal. Dept. Soc., Working Paper No. 82, 1985) (*citing* KENNETH ARROW, THE LIMITS OF ORGANIZATION (1974)).

socialized."[226] Trust is thus considered a background condition for economic exchange.[227] Economists recognize that contract enforcement, and other governance mechanisms that depend on altering incentives by means of sanctions, operate against what they conceive of as background conditions of "generalized norms of trust and trustworthiness" and kick in only "when the limits of baseline norms of trust and trustworthiness are reached."[228] But it is precisely these "background conditions" that have been shaped profoundly by fiduciary law and its prescriptions.

Put differently, the fiduciary principles adopted by attorneys helped institute a culture of professionalism in the U.S. The success of attorneys (both as trusted agents and as economic actors) validated this model of professional conduct and disseminated it more widely within the U.S. as a general culture of governance. It gave attorneys a special role in the U.S., not merely in bringing confidence to uncertain markets, but, as Tocqueville described, giving attorneys a prominent role in public administration.[229]

The success of attorneys as fiduciary agents contributed to economic development. Agency, as we have seen, is a social structure critical for promoting the division of labor and the specialization of functions. It bridges social and physical distances to enable exchange. And it provides the building blocks for more complex economic organization like partnerships and corporations. Attorneys played their critical role as agents because of their adoption of fiduciary norms.

D. Fiduciary Law Cannot Be Reduced To Contract

Economics and organizational theory have recognized trust as the most efficient mechanism for governing transactions. And yet, the law of trust as a concrete and distinct institution that supports economic development disappears in the economic analysis.

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[226] Williamson, *supra* note 66, at 98.
[227] *See also* NORTH, *supra* note 4, at 36-39 on informal contraints.
[228] Hadfield, *supra* note 5.
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> Men who make a special study of the law take from their work certain habits of order, a taste for forms, and a sort of instinctive love of regular sequence in ideas . . . . The special knowledge of lawyers acquire through the study of law assures them of a distinctive rank in society. They constitute a kind of privileged class among the intelligent. . . . In any free government, no matter what its form, lawyers will always be found in the front ranks of all parties.

ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA, VOL. I, 303 (Arthur Goldhammer trans., 2004) (1835).

In the law and economics literature, fiduciary obligations are viewed as nothing more than implicit agreements.[230] This view is based on the economic theory of incomplete contracts.[231] Law and economics scholarship maintains that fiduciary duty is a doctrine of judicial discretion, which enables courts to apply their judgment, based on general principles of obligation and precedent, to create particularized contract terms *ex post* that the parties would have negotiated and accepted *ex ante*, had they anticipated the dispute at hand.[232] Thus Easterbrook and Fischel write:

> [A] "fiduciary" relation is a contractual one characterized by unusually high costs of specification and monitoring. The duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced. The usual economic assessments of contractual terms and remedies then apply. 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.[233]

Fiduciary duties thus become "gap fillers" in incomplete contracts.[234] In their original articulation of the thesis, Easterbrook and Fischel claimed that "the law is designed to promote the parties' own perception of their joint welfare. That objective calls for filling gaps in fiduciary relations the same way courts fill gaps in other contracts. The subject matter may differ, but the objective and therefore the process is identical."[235] Moreover, they view the fiduciary duty to act in good

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[230] *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians,* 65 WASH. L. REV. 1, 4 (1990) ("[W]e present a comprehensive response to prominent corporate law commentators who have argued that private ordering of corporate manager duties should be restricted by mandatory rules."); Cooter & Freedman, *supra* note 19 at 1045; Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 Cornell L. Rev. 1266, 1273 (1999); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. LAW & ECON. 425 (1993); John Langbein, *The Contractarian Basis of Trusts*, 105 YALE L.J. 625 (1995); Ribstein, *supra* note 23, at 899; Larry E. Ribstein, Are Partners Fiduciaries?, 2005 U. ILL. L. REV. 209, 215 ("Fiduciary duties are a type of contract term that applies, in the absence of a contrary agreement, where an 'owner' who controls and derives the residual benefit from property delegates open-ended management power over property to a 'manager.'"); Sitkoff, *supra* note 19;.

[231] *See* Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 *Econometrica*, 755 (1988).

[232] Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra*, note 230; *see also* Simon Johnson, Rafael La Porta, Florencio Lopez-De-Silanes, & Andrei Shleifer, *Tunneling*, 90 AMER. ECON. REV. 22 (2000).

[233] *Id.*, at 427.

[234] *See also*, Sitkoff, *supra* note 19, at 203 ("Because agency problems arise from incomplete contracting, the core duties of loyalty and care are phrased in general terms. The duties of loyalty and care are *standards* that allow the court to decide whether, in view of all the circumstances, the fiduciary acted in accord with what the parties would have agreed if they had been able to anticipate those circumstances.")

[235] Easterbrook & Fischel, *supra* note 230, at 429. Note that the constriction of view upon the "joint welfare" of the parties involved in this particular contract at this time ignores that the special

faith, not as an obligation different in character, but merely as a somewhat more intense expression of the implied covenant of good faith and fair dealing in contract.

In a recent article of the economic theory of fiduciary duty, Robert Sitkoff restates the contractarian view that fiduciary law is an institutional strategy to address the agency problems that "arise from incomplete contracting."[236] Sitkoff writes that "[u]nder the fiduciary governance strategy, an agent who has broad discretionary power may act in the moment, but afterwards the principal is invited to scrutinize whether the agent's action was indeed in the principal's best interests. Stripped of legalistic formalisms and moralizing rhetoric, the functional core of fiduciary obligation is *deterrence.*"[237] Sitkoff argues that fiduciary duties, for the most part, yield to contrary agreement by the parties. Moreover, the standards-like approach allows courts "to decide whether, in view of all the circumstances, the fiduciary acted in accord with what the parties would have agreed if they had been able to anticipate those circumstances. In effect, the loyalty and care standards empower the court to complete the parties' contract after the fact." And the availability of disgorgement, "reflects the additional disclosure and deterrence purposes of fiduciary law."[238] He concedes that there is a "mandatory core" to fiduciary obligations, which "addresses the need for clean lines of demarcation" between fiduciary relations and other types of contracts. He thus recognizes that "fiduciary obligation is a necessary constitutive element of certain legal categories, such as trust and agency."[239] But the efficacy of fiduciary law can be fully explained by understanding it in terms of contract and rational expectations theory.

There are several problems with the contractarian view of fiduciary law.

First, as we have seen, fiduciary law and contract law are doctrinally distinct. Second, fiduciary law takes direct aim at opportunism in a way that contract, with its *ex ante* perspective, cannot. Third, fiduciary law produces trust by constructing the agency relationships as a "moral stance" that reorients the cognitive perspective of the agent.

To understand why, it is worth recalling that institutionalists model their concept of contract as a governance mechanism on the classical, voluntarist theory of contract. This model does not purport to describe contract as lawyers and judges understand it.[240] Rather it builds a model of the contractual relation using non-legal concepts and behavioral assumptions, and turns it into an analytic tool. Transaction cost economics then deploys this tool to explain different types of contractual

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obligations of fiduciary duty may promote norms that support economic development more generally by preventing market failure or organizational failure. WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 4; A.O. HIRSHMANN, EXIT, VOICE AND LOYALTY (1970).

[236] Sitkoff, *supra* note 19, at 202.

[237] *Id.* at 202; *see also* 200-201.

[238] *Id.* at 207.

[239] *Id.* at 205.

[240] *See, e.g., id.* at 197-98, 208 (analyzing doctrine in terms of economic theory).

arrangements (bilateral contracts; asset specific investments; principal-agent relationships), making predictions about their outcomes under varying conditions, and assessing the implications for public policy. Contractual analysis, moreover, is not merely applied to what the law describes as contract, but to the economic analysis of institutional arrangements and organizational structure more generally. Institutional Economics, on which law and economics relies, treats contracts as "analytical tools" that apply "to almost any relationship: from transactions between firms to any relationship among entities."[241]

The power of this analytic approach, however, also spells out its limitations. Its behavioral assumptions make the legal construction of an economic culture disappear.

VII. Policy Implications

A. The Rule of Law Debate

The idea that formal legal systems provided a necessary framework for modern economic development was an influential thesis of Max Weber's work on the rise of capitalism in the West.[242] Weber attributed the vast differences in economic development between modern industrialized nations and the rest of the world to the emergence of formal legal institutions in advanced national economies.[243] In the 1960s, the U.S. "law and development movement" – influenced by modernization theory and Weber's instrumentalist conception of law[244] – advocated for reform of legal education and the legal profession in developing countries as a means to stimulate the modernization of state institutions and thereby to jump start economic development.[245]

Drawing, at least in part, on these ideas, New Institutional Economics (NIE) introduced (neo-classical) economics to the notion that the legal environment is an

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[241] Éric Brousseau, *Contracts: From Bilateral Sets of Incentives to the Muli-Level Governance of Relations*, *in* NEW INSTITUTIONAL ECONOMICS: A GUIDEBOOK 37, 37 (Éric Brousseau & Jean-Michel Glachant eds., 2008).

[242] Economy and Society (_______); David Trubek, *Toward a Social Theory of Law: An Essay on the Study of Law and Development*, 82 Yale L. J. 1 (1972).

[243] David M. Trubek, *Max Weber on Law and Capitalism*, 3 Wisc. L. Rev. 720 (1972).

[244] Davis & Trebilcock, 901.

[245] By the early 1970s, the law and development movement became widely regarded as a failure in the legal community. Kevin E. Davis & Michael J. Trebilcock, *The Relationship between Law and Development: Optimists versus Skeptics*, 56 AM. J. COMP. L. 895, 915-16 (2008). David Trubek and Marc Galanter's influential critique, *Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States*, 1974 Wisc. L. Rev. 1062, rejected the idea that American legal institutions could successfully be transplanted to developing countries as ethnocentric and naïve, given that sharp contrast with conditions in developing countries.

important determinant of economic activity.[246] Institutional Economists sought to investigate the sources and determinants of transaction costs in order to better understand the "subtle economizing purposes [that] are served by organizational variety."[247] and how institutional structure (rules) affects economic organization and economic performance.[248] Central to this approach was the focus on contract "broadly conceived" as the framework for economic cooperation and organization.[249] These views were influential with the World Bank and in the development community.[250]

Much of the institutionalist debate about the importance of law for economic development focusses on the questions whether "strong formal contract law and enforcement mechanisms are indispensable to economic development," or whether "much economic development is realizable through informal contracting mechanisms."[251] As discussed above, North claimed that "impersonal exchange with third-party enforcement…[via an effective judicial system] has been the crucial underpinning of successful modern economies involved in the complex contracting necessary for modern economic growth"[252] and that "the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World."[253] In contrast, Avner Greif, and other "contract-informalists", argue that "many exchange relations in historical and contemporary markets and developing economies are not governed – directly or indirectly – by the legal system," but that informal reputation mechanisms and social networks are able to impose sanctions on agents adequate to enforce agreements.[254] Both sides,

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[246] Thomas, *supra* note 4.

[247] WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 4, at 7.

[248] *Id.*; NORTH, *supra* note 4, at 12 (The most important message [of Coase], one with profound implications for restructuring economic theory, is that when it is costly to transact, institutions matter.") *Id.* at 28 ("Neither Coase nor many of the subsequent studies of transaction costs have attempted to define precisely what it is about transacting that is so costly, but that issue is central to the issues of this study…"); WILLIAMSON, ECONOMIC INSTITUTIONS, *supra* note 4, at 17 ("I submit that the full range of organizational innovations that mark the development of the economic institutions of capitalism over the pat 150 years warrant reassessment in transaction cost terms. The proposed approach adopts a contacting orientation and maintains that any issue that can be formulated as a contracting problem can be investigated to advantage in transaction cost terms.").

[249] Trebilcock & Leng, *supra* note 2, at 1520 (*citing* NORTH, *supra* note 4, at 54).

[250] *Id. see also*, Thomas, *supra* note 4.

[251] Trebilcock & Leng, *supra* note 2, at 1518.

[252] NORTH, *supra* note 4, at 90.

[253] NORTH, *supra* note 4, at 54.

[254] MICHAEL J. TREBILCOCK & MARIANA MOTA PRAO, WHAT MAKES COUNTRIES POOR?: INSTITUTIONAL DETERMINANTS OF DEVELOPMENT at 108-09 (2011) (citing Avner Greif, *Contracting, Enforcement, and Efficiency: Economics Beyond the Law*, *in* ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1996 at 239 (1997); *see also* WILLIAMSON, THE MECHANISMS OF GOVERNANCE 10 (1996) ("The main contractual action thus takes place between the parties in the context of private ordering…. Private ordering through ex post governance is … where the main action resides.")

however, share the same theoretical foundations in that they make the dilemmas of trust in contractual relationships between rational actors under conditions of uncertainty central to their understanding of economic organization. Even as institutional economics introduces information problems and other transaction costs into its analysis, it nonetheless frames its solutions to the dilemmas of trust in terms of contract.[255] As Kenneth Dam writes, "[t]hese kinds of problems exist across the entire spectrum of economic activities whenever a system of law is not in place or does not work effectively to give parties confidence that contracts will be carried out. This is the essence of the rule-of-law problem in many developing countries…"[256]

The institutionalist literature has evolved to recognize that the focus on contract law and theory as a framework is too narrow. Questions about the effectiveness of contract enforcement, the efficiency and integrity of the legal system, and the differences in economic productivity between common law and civil law systems broadened the inquiry about the legal institutions that support contractual commitments.[257] Others raised questions about the incentives of local populations to use legal innovations and "to demand institutions that work to enforce and develop the law."[258] But as Gillian Hadfield noted, "[w]ithout a far more detailed appreciation of the institutions that interact to produce 'contract law' we cannot hope to be able to investigate the relative cost and efficacy of institutions in different environments and to develop effective policy prescriptions for improving economic development and growth through improved contract enforcement."[259]

In this article, we provide such a detailed analysis. We call attention to, and examine, fiduciary law as a legal institution that defined and policed agency relationships. We argue that rise of fiduciary law was much more important to the

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[255] WILLIAMSON, MECHANISMS, *supra* note 4, at 10 ("transaction cost economics subscribes to Karl Llewelly's notion of contract as framework.")

[256] Kenneth W. Dam, *Institutions, History and Economic Development* 2 (John M. Olin Law & Econ., Working Paper No . 2712006), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875026; *see also* DAM, *supra* note 2; Hadfield, *supra* note 5 at 175-176 ("One of the fundamental contributions of transaction cost theory and institutional economics has been to focus attention on opening the 'black box' of contract enforcement, drawing attention to the institutions required to achieve effective and low-cost contract enforcement….The idea that the effectiveness of contract law is critical to the growth of economic activity is widespread in the literature on development and transition economies.").

[257] *See* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law,"* 63 EMORY L. REV. 1383 (2014). Hadfield, *supra* note 5, at 176-177.

[258] Hadfield, *supra* note 5, at 177.

[259] Hadfield, *supra* note 5, at 177. *See also*, Frank B. Cross, *Law and Economic Growth*, 80 TEX. L. REV. 1737, 1737 (2002) ("There remains a relative paucity of academic legal research about the . . . particular mix of laws and legal institutions [that] encourage the ultimate overall economic welfare of society.").

U.S. transition to capitalism than has been recognized. Economists recognize agency relationships as critical for economic development and economic organization. But they have missed the importance of fiduciary law, because they have conceptualized agency relationships in terms of contract theory and assimilated the fiduciary law to contract. We argue that fiduciary law is conceptually distinct from contract and effective in practice. We support this position by looking to theory, doctrine, and historical evidence of attorneys who were schooled in equity, and adopted and diffused fiduciary norms in response to a demand for their services among businessmen.

Our argument raises many questions for the law and economic development literature. It suggests that, in the U.S. at least, attorneys played an important role in diffusing norms of impersonal trust in U.S. commercial and professional culture. The availability of legal recourse alone, or the effectiveness of the judicial system in enforcing agency agreements, may have been sufficient to support certain types of contracts, but not necessarily the widespread use of impersonal agents and intermediaries. But as Arthur Chandler has argued, it was the rise of professional managers that marked an important shift in the development of industrial organization in the United States and distinguishes the U.S. corporate ownership structures from those in other countries, like Great Britain.[260] Fiduciary law, we suggest, was critical to the emergence of a culture of professionalism in the United States. While other national economies, like Germany, developed their own managerialism, different mechanisms, such as the influence of medieval guilds and their legal institutionalization, may have played a greater role in corresponding German developments – with importance differences in outcome.[261]

It is worth noting that the mandatory nature of fiduciary law and the no-profit rule has broad implications for combatting opportunism, honest services fraud, but also public corruption.

B. The Continued Relevance of Fiduciary Law

The importance of fiduciary principles to the efficiency of markets is a hotly contested issue in the governance of the contemporary American economy.

[260] ARTHUR CHANDLER, SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 3, 12 (2004); ARTHUR CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977).

[261] Chandler distinguishes American "competitive managerialism" from German "cooperative managerialism." CHANDLER, SCALE AND SCOPE, *supra* note 260, at 12. The competitive nature of U.S. managerial capitalism, which Chandler contrasts with German "cooperative managerialism," may also have to do with the substantive conception of agency that fiduciary law constructs. The emphasis in fiduciary on the duty to act in the best, or even "sole" interests of a principal, establishes the role of agent as one that is perhaps more forcefully set apart from considerations of ordinary morality than other conceptions of agency. The American fiduciary rule has indeed been criticized on this account. Wasserstrom, *supra* note 224.

In a recent Presidential Memorandum, President Trump empowered the Secretary of Labor to rescind or revise a Department of Labor rule that would have required anyone who provides investment advice for a fee in connection with a retirement plan to be subject to a fiduciary standard.[262] The rule, which was supposed to go into effect on April 10, 2017, would have raised the standard by which the conduct of many financial advisors is judged.[263] Under current law, broker/dealers who provide investment advice in connection with retirement accounts need only provide "suitable" advice to their clients and are therefore allowed to recommend investment products that generate higher fees for them, even if the investment products are not the best choice for their clients.[264]

Trump's Presidential Memorandum suggests that fiduciary law increases transaction costs and is likely to impinge on the financial markets. If the Department of Labor rule were implemented, it might "reduc[e] Americans' access to certain retirement savings offerings," "harm investors," "cause an increase in litigation," and "increase the prices that investors and retirees must pay to gain access to retirement services."[265] When the rule was originally proposed, industry groups made similar arguments, claiming that it would interfere with the market for investment products and encourage companies to drop investment products for less wealthy investors, ultimately limiting consumer choice.[266]

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[262] Presidential Memorandum on Fiduciary Duty Rule (February 3, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule. For the proposed rule see Definition of the Term "Fiduciary"; Conflict of Interest Rule--Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 6, 2016) (to be codified at 29 C.F.R. §§ 2509, 2510, 2550); *see also* Nelson S. Ebaugh, *The Dol's New Fiduciary Duty Rule Leads to Expanded Statutory Causes of Action and A New Breach of Contract Claim*, FED. LAW., January/February 2017, at 66.

[263] Michael Wursthorn, *Fiduciary Rule or Not Brokerages Have Made Plans*, WALL ST. J. Feb. 7, 2017, at B10.

[264] Yuka Hayashi, *Banking & Finance: Genie Out of Bottle, Rule's Architect Says*, WALL ST. J., Feb. 6, 2017, at B8.

[265] Presidential Memorandum on Fiduciary Duty Rule, *supra* note 262.

[266] *See* Peter Schroeder, *White House Locks in New Rules for Financial Advisors,* HILL, April 6, 2016, *available at* http://thehill.com/policy/finance/275269-white-house-locks-in-new-rules-for-financial-advisers ("The financial industry has fought tooth and nail against the regulations, arguing they will impose a massive burden on financial firms and make it harder for less wealthy Americans to obtain expert financial advice."); Jonnelle Marte, *Labor Department's Fiduciary Rule Is Upheld*, WASH. POST, Feb. 9, 2017, at A15. There is some empirical evidence that such claims deserve credence. *See* Jill E. Fisch, Tess Wilkinson-Ryan, & Kristin Firth, *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 DUKE L.J. 633, 547 n81 (2016) (citing studies on "a somewhat different" British regulation that may have discouraged investors from seeking "professional financial guidance") (citing ANDREW CLARE CASS CONSULTING, THE GUIDANCE GAP: AN INVESTIGATION OF THE UK'S POST-RDR SAVINGS AND INVESTMENT LANDSCAPE 1 (2013), http://www.cassknowledge.com/sites/default/files/article-attachments/the-guidance-gap.pdf; Andrew Clare, Steve Thomas, Omal Walgama & Christina Makris, Challenge and Opportunity: The Impact of the RDR on the UK's Market for Financial Advice 16 (Cass Bus. Sch. & BNY Mellon, Draft No. 4, 2013),

In making its case for the fiduciary rule, the Council of Economic Advisers put a price on its value. They concluded, based on a survey of economic literature, that conflicted advice cost investors roughly 1 percentage point in returns per year. With $1.7 trillion IRA assets of investors receiving conflicted advice, the annual cost is about $17 bln dollars.[267] This figure was arrived at by comparing the returns of conflicted advice with returns on funds sold without advice.

But this figure does not fully account for the added value of services provided by fiduciaries.[268]

Avoiding conflicts of interest is not the same as providing advice that is in the best interests of the client. The concern for the "best interests" of the client require fiduciary advisors to perform a different type of analysis than the "suitability" analysis. It requires the exercise of informed judgment on behalf of, and in the best interests of, the client. The "prudent investor standard," which applies to fiduciaries under the Restatement of Trusts, provides guidance to financial advisors as to what such informed judgment should look like.[269] Among the circumstances that a fiduciary must consider in managing trust assets under the Prudent Investor Rule, are the following:

> - general economic conditions;
>
> - the possible effect of inflation or deflation;
>
> - the expected tax consequences of investment decisions or strategies;
>
> - the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interest in closely held enterprises, tangible and intangible personal property, and real property;
>
> - the expected total return from income and the appreciation of capital;
>
> - other resources of beneficiaries;
>
> - needs for liquidity, regularity of income, and preservation or appreciation of capital; and
>
> - an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.[270]

The prudent investor standard thus spells out the difference between a positive exercise of informed judgment on behalf of, and in the best interests of, a

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http://www.cassknowledge.com/sites/default/files/article-attachments/bny-mellon-rdr-cass-knowledge.pdf.

[267] Council of Economic Advisers, *The Effect of Conflicted Investment Advice on Retirement Savings*, at 26 (Feb. 2015).

[268] *See, e.g.*, Max M. Schanzenbach & Robert H. Sitkoff, *Fiduciary Financial Advice to Retirement Savers: Don't Overlook the Prudent Investor Rule*, Harvard John M. Olin Center for Law, Economics, and Business Working Paper No. 867, at 1 (June 2016), *available at* *https://ssrn.com/abstract=2795037*.

[269] *See* Melanie L. Fein, *Brokers and Investment Advisors Standards of Conduct: Suitability vs. Fiduciary Duty*, 33-34 (August 31, 2010), *available at* http://dx.doi.org/10.2139/ssrn.1682089.

[270] Uniform Prudent Investor Act § 2 (c)

client, as opposed to the mere avoidance of a conflict of interest. It is this difference that is missed where the sole focus is on self-interested contracting and deterring opportunism.[271] As we have suggested above, the fiduciary principle thus encourages a cognitive reorientation of the agent, which changes the agent's exercise of judgment. The cost of the conflicted advice does not account for the added value of the judgment of investment advisors who are fiduciaries. The $17 bln value that the Council on Economic Advisors put on the fiduciary rule is thus much too conservative.

Background conditions of trust in financial professionals may also be affected by the failure to implement a fiduciary standard for all financial advisors. The development of the financial industry has resulted in a situation where broker/dealers, who were previously exempt from fiduciary obligations under the Investment Advisors Act, because they had a different role in the industry, are now also engaged in providing financial advice to clients for a fee.[272] Almost half of their clients believe that these financial advisers are already required to put their clients' interests first when it comes to retirement advice.[273] If customers find that they are being misled, this may have broader implications for the public's view of financial professionals.

Given the complexity of the fiduciary rule and the trade-offs that were required in accommodating the dual role of broker-dealers as both financial advisers and principals who sell securities to their clients, we cannot take a position here on whether, on balance, the rule, in its present form, is advisable. But our analysis shows that the added value of the fiduciary role is not sufficiently appreciated in much of the literature.[274]

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[271] While doctrine distinguishes duties of loyalty and care – and the prudent investor rule is a duty of care – both are comprised within the fiduciary principle. The development of this argument goes beyond the scope of this paper. What is clear, is that the prudent investor rule spells out the much more comprehensive analysis that is involved in making judgments based on the best interests of a particular investor. *Id.* at 2 ("Under the prudent investor rule, a fiduciary must evaluate the principal's risk tolerance and investment goals, choose a commensurate level of overall portfolio market risk and expected return, and avoid wasteful diversifiable risk. Because of the multiplicity of relevant considerations – including the investor's risk preferences, age and health, career, family status and obligations, and other asset holdings and sources of income – application of the prudent investor rule is specific to an investor's particular circumstances.")

[272] *See*, Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisors*, 65 BUS. LAWYER 395, 400-408 (2010).

[273] Liz Skinner, *Figuring Out Fiduciary: Now Comes the Hard Part*, 17 INVESTMENT NEWS (May 9, 2016), *available at http://www.investmentnews.com/article/20160509/FEATURE/160509939/the-dol-fiduciary-rule-will-forever-change-financial-advice-and-the*.

[274] *See also*, Michael S. Finke, *Fiduciary Standard and Financial Advice: Findings from the Academic Literature*, at 7 available at Finke, Michael S., Fiduciary Standard and Financial Advice: Findings from Academic Literature (April 2, 2014) ("The primary distinguishing feature between fiduciary and suitability standards in the United States is the method of compensation (fees versus commission) and the potential punishment for exceedingly self-serving recommendations (FINRA

VIII. CONCLUSION

This article argues that certain norms of trust (and trusteeship) articulated by the law of fiduciaries have influenced the governance of agency relationships in ways that are not fully appreciated. Fiduciary norms, we suggest, are much more important for the organization of economic activity in early American capitalism than other theories would suggest.[275]

By privileging contract law as a framework for economic analysis, Institutional Economics underestimates the resources that the law brings to bear on classic problems of information asymmetry, transaction costs, and opportunism. Law, other than contract law, creates markets by addressing these problems. Markets do not preexist independently of the legal institutions that provide the framework for exchange.

Instead of focusing on the costs of agency relationships and understanding the intermediation of attorneys as generating transaction costs, our account of the work of attorneys in the nineteenth century highlights the fact that such agency relationships lowered the costs of transacting and made transactions possible.

Our account is important not only for understanding economic development, but for understanding how the American economy works today. Fiduciary law, not contract law alone, provides an important institutional framework within which transactions take place. Fiduciary law provides formal recourse, but also supports informal norms of tremendous importance for the institutions of our complex economy.

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penalties and arbitration losses versus civil judgments and federal penalties).") *Available at https://ssrn.com/abstract=2419727 or http://dx.doi.org/10.2139/ssrn.2419727*

[275] *See, e.g.,* Shapiro, *supra* note 74 at 625-29 (discussing the proliferation of agency relationships in dispersed and impersonal markets that characterize complex economies).