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## A Cognitive Theory of Trust

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# A COGNITIVE THEORY OF TRUST

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## I. INTRODUCTION

Interpersonal trust is currently receiving widespread attention in the academy. A fast-growing legal literature can draw insights from trust scholars in several other fields, including sociology,<sup>1</sup> psychology,<sup>2</sup> political science,<sup>3</sup> economics,<sup>4</sup> neuroscience,<sup>5</sup> medicine,<sup>6</sup> and management<sup>7</sup> to explore the effects of legal policy on the nature of trust in interpersonal relationships. The issues are fundamental and worthy of more serious exploration: To what extent do legal rules, cases, and law enforcement efforts enhance or detract from the trust present in

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1. See, e.g., FRANCIS FUKUYAMA, *TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY* (1995); *TRUST: MAKING AND BREAKING COOPERATIVE RELATIONSHIPS* (Diego Gambetta ed., 1988).

2. See, e.g., Morton Deutsch, *Cooperation and Trust: Some Theoretical Notes*, in 10 *NEBRASKA SYMPOSIUM ON MOTIVATION* 275 (1962); Philip Worchel, *Trust and Distrust*, in *THE SOCIAL PSYCHOLOGY OF INTERGROUP RELATIONS* 174 (William G. Austin & Stephen Worchel eds., 1979).

3. See, e.g., BERNARD BARBER, *THE LOGIC AND LIMITS OF TRUST* (1983); RUSSELL HARDIN, *TRUST AND TRUSTWORTHINESS* (2002); Jack Knight, *Social Norms and the Rule of Law: Fostering Trust in a Socially Diverse Society*, in *TRUST IN SOCIETY* 354 (Karen S. Cook ed., 2001).

4. See, e.g., KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* (1974); Kevin A. McCabe & Vernon L. Smith, *A Comparison of Naïve and Sophisticated Subject with Game Theoretic Predictions*, 97(7) *PROC. NAT'L ACAD. SCI.* 3777 (2000); PAUL SEABRIGHT, *THE COMPANY OF STRANGERS: A NATURAL HISTORY OF ECONOMIC LIFE* (2004).

5. See, e.g., Brooks King-Casas et al., *Getting to Know You: Reputation and Trust in a Two-Person Economic Exchange*, 308 *SCIENCE* 78 (2005); Paul J. Zak et al., *The Neurobiology of Trust*, 1032 *ANNALS N.Y. ACAD. SCI.* 224 (2004); Michael Kosfeld et al., *Oxytocin Increases Trust in Humans*, 435 *NATURE* 673 (June 2, 2005).

6. See, e.g., Mark A. Hall et al., *Measuring Patients' Trust in Their Primary Care Providers*, 59 *MED. CARE RES. & REV.* 293 (2002); David H. Thom & Bruce Campbell, *Physician-Patient Trust: An Empirical Study*, 44 *J. FAM. PRAC.* 169 (1997).

7. See generally *Special Topic Forum on Trust In and Between Organizations*, 23(3) *ACAD. MGMT. REV.* 387 (Sim B. Sitkin et al. eds., 1998); *TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH* (Roderick M. Kramer & Tom R. Tyler, eds., 1996).

relationships? How can a better understanding of trust help us devise tools to improve human social and economic interactions?

Interpersonal trust has been approached thus far from two different normative perspectives. Scholars outside of the criminal law typically assert that trust should be maximized. For example, Francis Fukuyama recently highlighted the importance of trust in the development of both large corporations and closely affiliated smaller corporations.<sup>8</sup> According to his theory, spontaneous sociability is fostered in some societies by the development of social, professional, political, and religious organizations.<sup>9</sup> Affiliation in these organizations enables individuals to develop trusting business relationships that foster growth and help the society to produce large amounts of wealth.<sup>10</sup> Individual firms that can maximize constituents' trust in one another can garner a competitive advantage over those who make less effective use of trusting relationships.<sup>11</sup> In this regard, Margaret Blair and Lynn Stout note that interpersonal trust can work to solve many of the contracting issues emphasized in traditional law and economics scholarship:

Where trust can be harnessed, it can substantially reduce the inefficiencies associated with both agency and team production relationships. Trust permits transactions to go forward on the basis of a handshake rather than a complex formal contract; it reduces the need to expend resources on constant monitoring of employees and business partners; and it avoids the uncertainty and expense associated with trying to enforce formal and informal agreements in the courts. Trust behavior also reduces losses from others' undetectable or unpunishable opportunistic behavior, losses that could discourage the formation of valuable agency and team production relationships in the first place.<sup>12</sup>

In contrast, criminal law scholars worry that interpersonal trust among criminals generates harm rather than benefits to society. After all, criminal conspiracies are the most potent enemy of those attempting to fight crime. Group engagement in criminal behavior is thought to increase the scope,

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8. See FUKUYAMA, *supra* note 1.

9. *Id.* at 27–32.

10. *Id.* at 27–28.

11. *Id.* at 30.

12. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1757 (2001). A recent book discussing in detail the benefits of trust is TAMAR FRANKEL, *TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD* (2006)

severity, and frequency of criminal behavior; moreover, the dangerousness of conspiracies tends to grow with the degree of trust that each co-conspirator places in his collaborators. One important point of conspiracy laws, RICO, antitrust laws, and their accompanying law enforcement and prosecution tactics, is to attempt to minimize the extent to which co-conspirators trust one another.<sup>13</sup>

Trust can also be a problem for outsiders and underdogs.<sup>14</sup> Individuals who affiliate with one another socially are more likely to trust one another in business; members of the lower classes, minorities, and other outsiders may therefore find it difficult to succeed economically. After all, the most reliable forms of interpersonal trust build in small groups of individuals who interact repeatedly, and time constraints limit people's abilities to build new repeat interaction relationships. As a consequence, high trust relationships tend to be characterized by discrimination in favor of the trusted group members and against outsiders; trust can therefore lead to discrimination in both legitimate (i.e., not dealing with cheaters) and illegitimate (i.e., not dealing with Asian or African Americans) forms. Put differently, preestablished interpersonal trust relationships can stand in the way of those seeking a more open and egalitarian society.<sup>15</sup>

Our contribution to the trust literature is twofold. First, we make an intuitively simple but important point: although there are situations where legal policy should work to either maximize or minimize interpersonal trust, in general, the law should seek to *optimize* interpersonal trust. Individuals can be too trusting or not trusting enough. Undertrust results in foregone beneficial opportunities, paranoia, and unnecessary tensions, but overtrust leads to ineffective monitoring, fraud, reduced efficiency, and incompetence. As with most problems in life and law, the challenge lies in finding the appropriate balance.

To illustrate this first point, consider a Sunday afternoon drive in the countryside. In many areas of the country, you will find items for sale along the road—fresh fruit and vegetables, honey, jams and jellies, cut flowers, etc. Many of the people who sell these items do not carefully monitor their tables. A stand with very large quantities of goods for sale is often monitored, but a stand with a small quantity of goods may well be

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13. See Neal Kumar Katyal, *Conspiracy Theory*, 112 YALE L.J. 1307, 1346–50 (2003); Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515, 622–50 (2004).

14. See Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457, 1531–43 (2005).

15. See, e.g., Elinor Ostrom, *Toward a Behavioral Theory Linking Trust, Reciprocity, and Reputation*, in TRUST AND RECIPROCITY: INTERDISCIPLINARY LESSONS FROM EXPERIMENTAL RESEARCH 19, 45 (Elinor Ostrom & James Walker eds., 2002) (discussing dark side of reciprocity norms).

left unattended. Interestingly, even those farmers who are willing to trade on an honor system take steps to protect their proceeds. A jar of jelly can be easily swiped, but the cash box typically has a very narrow slit that prevents the money from being taken out. Moreover, the box is often affixed to the table or stand to prevent easy theft.<sup>16</sup> These farmers are neither wholly distrusting nor wholly trusting. They therefore leave themselves vulnerable to theft of a few jars of jelly, but not to ready theft of the cash box proceeds. In many cases, the law should and typically does encourage individuals to replicate this sense of balance. In other cases, the law should work to at least minimize the costs of overtrust or undertrust that cannot or should not be corrected.

As discussed in Part II of this Article, legal scholars have previously overlooked the problem of optimizing trust in part because they have either ignored or paid insufficient attention to some of the features of trust. Most importantly, legal scholars have incorrectly assumed that trust and distrust cannot coexist. In most relationships, however, the parties trust one another with regard to some matters and yet distrust one another with regard to other matters. More specifically, developing a relationship with somebody often involves acquiring an overall *residual* sense of how trustworthy the person is, as well as a *specific* sense of the person's trustworthiness in particular contexts. Given the routine coexistence of trust and distrust, policymakers should not be forced to take an all-or-nothing position regarding the desirability of interpersonal trust.

Our second contribution to the trust literature is to begin to develop a cognitive theory of trust. We argue that trust is a nuanced cognitive assessment of another's trustworthiness, and that it is made using both conscious and subconscious processes. We assess others' residual trustworthiness as well as make more specific assessments: I generally trust Smith, but not to arrive on time. A person's assessment of another's trustworthiness is sometimes mostly a prediction as to the other's behavior, something we label "trust that" trust. I "trust that" the pizza delivery man will deliver the pizza I ordered. But we sometimes also assess a more internally based attribute, which we label "trust in" trust: a person will act in a certain manner, either because she is motivated by our well-being or because of her values. I "trust in" Smith to repay the ten dollars he borrowed from me, in part because (I believe) he believes in repaying his debts. The process by which we make our assessments does

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16. This example is a version of that offered in Robyn M. Dawes & Richard H. Thaler, *Anomalies: Cooperation*, 2 J. ECON. PERSP. 187, 195 (1988).

not always serve us or society as well as it could—we do not always trust optimally. Our Article argues that law has an important role to play in encouraging optimal trust and optimal trust assessments. Interestingly, sometimes the more optimal assessment is also more accurate; at other times, it may be optimal for people to trust more or less than is accurate.

Trust can be nonoptimal for two very different reasons. First, trust can be socially suboptimal. As discussed in Part III, people sometimes trust members of their own social group, and distrust members of other groups in ways that limit beneficial interactions within a society.<sup>17</sup> The trust assessments may or may not be accurate, but they are certainly rational; people are probably better able to appraise and sanction members of their own group than members of other groups. In-group trust can also increase problematic interactions within a society; those engaged in criminal conduct can do so more effectively in groups whose other members they trust completely. In the former case, policymakers might encourage the acquisition of trust-relevant information about strangers and thereby encourage dealings with them; in the latter case, policymakers might discourage dealings with non-strangers by rewarding them when they inform on one another. The strategy is the opposite: to set up incentives to *discourage* the acquisition of trust-relevant information.

Second, trust can be individually suboptimal. In some contexts, individuals have difficulty accurately processing trust-relevant information. Often in such contexts, the law should intervene. Sometimes, the intervention should aim to promote more accurate trust levels, but at other times, it should not, instead seeking to mitigate the costs of the mistaken assessments.

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17. For example, Fukuyama focuses on countries like China, Italy, and France, where although family ties are quite strong, the non-kin trust relationships necessary to form efficient large-scale business operations are lacking. See FUKUYAMA, *supra* note 1, at 61–125. The failure of these societies to provide for mechanisms where “spontaneous sociability,” a type of social capital, can develop causes them to suffer economically. *Id.* at 27–29. As Fukuyama points out:

Social capital has major consequences for the nature of the industrial economy that society will be able to create. If people who have to work together in an enterprise trust one another because they are all operating according to a common set of ethical norms, doing business costs less. Such a society will be better able to innovate organizationally, since the high degree of trust will permit a wide variety of social relationships to emerge . . . .

By contrast, people who do not trust one another will end up cooperating only under a system of formal rules and regulations, which have to be negotiated, agreed to, litigated, and enforced, sometimes by coercive means. This legal apparatus, serving as a substitute for trust, entails what economists call “transaction costs.” Widespread distrust in a society, in other words, imposes a kind of tax on all forms of economic activity, a tax that high-trust societies do not have to pay.

*Id.* at 27–28.

Part IV explores some specific policy implications of a cognitive focus on optimal trust in the areas of corporate governance and of patient care and treatment. In both of these areas, overtrust is at issue. In corporate governance, we believe that board members have sometimes overtrusted corporate officers. This overtrust contributed to the recent corporate scandals, as directors did not monitor sufficiently to detect officers' misdeeds. Directors and officers come from the same groups; overtrust is therefore not surprising. Moreover, officers effectively pick the directors, assuring that particular directors are those whom officers think will trust them. We argue that this overtrust can, and should, be corrected—that the law can and should encourage directors to make more accurate trust assessments. Our recommendation contrasts with the emphasis of many reform efforts to increase independence of the board. More independence is indicated if the directors turned a blind eye or, worse still, chose to permit misdeeds on account of their shared ties with the officers. Far more likely is that the directors simply were overtrusting—assessing the trustworthiness of the officers in a manner that made them believe the officers did not warrant higher degrees of scrutiny and second-guessing. If we are right, the focus on increasing independence may sacrifice valuable collegiality and business knowledge without offering commensurate benefits.

In Part IV, we also analyze some implications of trust for the regulation of the doctor-patient relationship. Patients tend to think of their doctors as nearly godlike in both their capabilities and their loyalty to patients. These beliefs form quite early in the doctor-patient relationship and, in many cases, constitute overtrust. Moreover, for reasons that we elaborate on in Part IV, patients are unlikely to carefully process trust-relevant information accurately. But, in contrast with directors' overtrust of officers, we think that this "sticky" trust in the doctor-patient context serves more useful purposes than does "sticky" trust in the officer-director context, so we do not ultimately advocate that the law work to better inform patients about the trustworthiness of their doctors. For the most part, the law should instead attempt to mitigate the costs of the inaccurate trust assessments by imposing heightened duties on doctors themselves and by encouraging heightened scrutiny by third-party monitors.

## II. ON THE NATURE OF TRUST (AND DISTRUST)

Trust is an essential component of human relationships and a fundamental building block of healthy societies. Despite its importance, scholars from the various disciplines relevant to trust have failed to



converge on a single definition.<sup>18</sup> Trust experts all seem to agree that trust is a state of mind that enables its possessor to be willing to make herself vulnerable to another—that is, to rely on another despite a positive risk that the other will act in a way that can harm the truster.<sup>19</sup>

But beyond this feature, scholars diverge. In particular, some see trust as principally behavioral, akin to cooperation.<sup>20</sup> We agree that trust necessarily has behavioral ramifications: trust significantly affects who we choose to deal with and how closely we monitor them in the course of our dealings. But we view trust as essentially cognitive,<sup>21</sup> and therefore align ourselves with those scholars who place trust “in the family of such notions as knowledge, belief, and the kind of judgment that might be called assessment.”<sup>22</sup> Unlike cooperation, trust need not involve action. Cooperation can, but need not result from trust; alternatively, it could result from purely altruistic desires. Moreover, as discussed in Part III.B, trust requires more than simple cooperation. It requires, in addition, a sense of entitlement to return beneficence.<sup>23</sup>

To some scholars, trust involves nothing more than a prediction, or a statement of confidence, about how another will behave,<sup>24</sup> as in “I trust that Tom will come today to fix the sink.” The prediction cannot rise to the level of certainty:<sup>25</sup> if I am certain that Tom will come today to fix the

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18. See generally Denise M. Rousseau et al., *Not So Different After All: A Cross-Discipline View of Trust*, 23(3) ACAD. MGMT. REV. 393, 394 (1998); Diego Gambetta, *Can We Trust Trust?*, in TRUST, *supra* note 1, at 213.

19. “Trust is not a behavior (e.g., cooperation) or a choice (e.g., taking a risk), but an underlying psychological condition that can cause or result from such actions.” Rousseau et al., *supra* note 18, at 395; see also Blair & Stout, *supra* note 12, at 1739–40; Jan Delhey & Kenneth Newton, *Who Trusts? The Origins of Social Trust in Seven Societies*, 5 EUR. SOCIETIES 93, 105 (2003) (providing “a working definition of trust as the belief that others will not, at worst, knowingly or willingly do you harm, and will, at best, act in your interests.”).

20. For example, the experimental economists all assume that trust is observed whenever their first-mover subjects cooperate. See *infra* notes 33–40 and accompanying text.

21. See Russell Hardin, *Conceptions and Explanations of Trust*, in TRUST IN SOCIETY, *supra* note 3, at 5–6 (discussing and rejecting the view that trust is noncognitive).

22. HARDIN, *supra* note 3, at 7.

23. See *infra* note 31 and accompanying text.

24. See David Good, *Individuals, Interpersonal Relations, and Trust*, in TRUST, *supra* note 1, at 31; Sirkka L. Jarvenpaa & Emerson H. Tiller, *Customer Trust in Virtual Environments: A Managerial Perspective*, 81 B.U. L. REV. 665, 672–75 (2001) (discussing scholars’ view of trust as probability assessment).

25. See Gerardo A. Guerra, *Crowding Out Trust: The Adverse Effects of Verification. An Experiment 2–3* (Univ. of Oxford, Discussion Paper Series No. 98, Apr. 2002) (arguing that trust requires three conditions: uncertainty, exposure, and temptation) (manuscript on file with authors).

sink, trust is not at issue.<sup>26</sup> To other scholars, trust involves confidence that another will incorporate the truster's welfare into his decisions and actions or that the trusted party has values that will lead her to act in the way the trusting person desires.<sup>27</sup> This latter trust involves an assessment of the qualities or internalized norms of another to behave in a loyal, honest, competent, and/or dependable fashion. Both types of trust interest legal scholars; an understanding of how people respond to trust or trust-encouraging measures can inform policy, regardless of whether trust involves a mere prediction of behavior or a more elaborate assumption about the internalized norms of another.

That said, however, the law (and social norms) can have the effect of promoting one type of trust yet substituting for the other. Consider the first type of trust discussed above—trust as prediction—or “trust that” trust. To the extent that the law provides incentives for Tom to show up on the day he promised or to carefully perform the task that we need him to perform, the law makes it easier for us to “trust that” he will come today to fix the problem. Moreover, to the extent that the society has in place norms for keeping promises and taking care that are backed by social and/or economic sanctions, social norms can similarly encourage us to “trust that” Tom will come today to fix the problem. Thus, law and social norms together can promote a person's confidence in the actions of another without the person considering whether the other is motivated solely to maximize his short-term selfish interests or, instead, by values that encourage him to behave in a trustworthy fashion without regard to his short-term self-interest. When “trust that” trust is present, the truster predicts that the other will behave in a way that is not harmful regardless of his character type.

In contrast, the second type of trust—where I “trust in” Tom to come today to fix the problem—is an attribute-based trust that is often stronger and more resilient than “trust that” trust. “Trust in” trust is not based directly on the immediate instrumental costs and benefits to Tom of

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26. HARDIN, *supra* note 3, at 12.

Giving people very strong incentives seems to move them toward being deterministic actors with respect to the matters at stake. At the other extreme, leaving them with no imputable reasons for action generally makes it impossible to trust them. Trust and trustworthiness (and choice and rationality) are at issue just because we are in the murky in-between land that is neither deterministic nor fully indeterminate.

*Id.*

27. See, e.g., John Dunn, *Trust and Political Agency*, in TRUST, *supra* note 1, at 73, 74 (describing trust as the expectation that another will act in ways not harmful to the trusting person).

performing the specific acts.<sup>28</sup> Rather, I “trust in” Tom to come today to fix the problem even when the law fails to provide incentives for him to come and there are no social norms or norm enforcement mechanisms in place to work separately to encourage him to come. In theory, “trust in” trust can be crowded out by legal mechanisms and social norms because strong external forces driving Tom to come today can prevent me from having to think about whether I actually “trust in” Tom. I know that I can “trust that” he will come, so I don’t have to question whether the stronger form of trust is warranted. Indeed, if Tom can earn a livelihood based merely on the fact that we “trust that” he will perform, he may have little incentive to invest in the more costly set of attributes that ensure that we can “trust in” him.<sup>29</sup>

Although law and social norms can work to encourage “trust that” trust, it is, at best, a substitute for “trust in” trust. However, our intuition is that in practice external factors are rarely so strong that they swamp “trust in” trust considerations altogether. No doubt legal duties and social norms can decrease the level of “trust in” trust necessary to get us to do business with Tom by increasing the degree to which we “trust that” he will come to fix the problem. Because detection and enforcement are both imperfect and costly, however, and because contracts are invariably incomplete, rarely is it the case that we are willing to sustain significant business relationships with individuals who we think are only constrained by costs and benefits and not by any internal motivations. Indeed, the absence of some positive amount of “trust in” trust seems sufficient, given the imperfect nature of external constraints, to forgo a potentially costly opportunity to interact.<sup>30</sup>

Some scholars would likely object to including “trust that” trust in our definition of trust. They would define trust more narrowly, by demanding that trust relationships are those where neither the truster nor the trusted

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28. We say not directly based because Tom may well garner benefits from possessing the attributes of loyalty, honesty, and/or trustworthiness, and we might “trust in” him (and others) because we know that the benefits exist to possessing these attributes. Nevertheless, a “trust in” assessment is based on a belief in Tom’s attributes rather than in the costs and benefits of the action itself.

29. In this sense, social and internal norms might work against one another.

30. Certainly, without “trust in” trust, a party will be quite concerned that the other can abide by the words of a contract but violate the contract’s spirit. By definition, there are no legal consequences to such behavior, and reputational consequences may be insufficient. Without “trust in” trust, a party will also have to be quite concerned about contingencies it does not anticipate: law does not help, and reputation-preserving norms might not help either. For a discussion of the general problem, see Claire A. Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 79 CHI.-KENT L. REV. 889 (2004); and Claire A. Hill, *Why Contracts are Written in “Legalese,”* 77 CHI.-KENT L. REV. 59 (2001).

are choosing their courses of action for instrumental reasons. Oliver Williamson, for example, takes the position that “‘calculated trust’ [is] a contradiction in terms.”<sup>31</sup> Williamson believes that, as a descriptive matter, in commercial relationships parties assess others’ instrumental interests and, based on that assessment, take “risks”; he thinks that “risks” are not akin in any meaningful sense to “trust.”<sup>32</sup> We think that Williamson’s position is ultimately unintelligible and mistaken. It is now understood that the distinctions between calculative and noncalculative decision-making and between instrumental and noninstrumental behaviors are by no means clear. Because trustworthy behavior is very often a result of both internalized noninstrumental values and instrumental motives, it becomes in practice quite difficult to separate out calculative from noncalculative trust-relevant behaviors. Furthermore, we believe that most longer-term relationships, including business relationships, cannot proceed without some measure of “trust in” trust. Indeed, because the presence of some “trust in” trust minimizes negotiating, contract drafting, monitoring, and enforcement costs, we can expect economic actors to, where possible, gravitate toward parties whom they “trust in.”

The remainder of this Part and the next attempt to sketch a cognitive framework for trust. Part II.A presents some of the experimental literature on social dilemmas. The experiments have been heavily relied on by legal scholars and have played an important role in enabling scholars across disciplines to better understand trust. In Part II.B, however, we reach beyond the social dilemma games and present a model of trust and distrust that has recently appeared in the management literature. After briefly exploring the implications of this richer view of trust, we move in Part III to explore some relationships where trust forms and trust-relevant information is processed in ways that can generate what appear to be nonoptimal trust levels.

#### *A. Social Dilemma Experiments and Trust*

Game theorists, experimental economists, and others have cast much of human cooperation in the mold of a social dilemma game,<sup>33</sup> and recently trust scholars have turned to the games to glean insights about what factors

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31. Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J.L. & ECON. 453, 485 (1993).

32. *Id.*

33. See Ostrom, *supra* note 15, at 19, 20 (“Social dilemmas abound in human affairs. They have been studied by biologists, economists, evolutionary psychologists, game theorists, historians, legal scholars, mathematicians, philosophers, political scientists, sociologists, and social psychologists.”).

affect interpersonal trust.<sup>34</sup> In a social dilemma game, individuals must make choices in a situation where their welfares are interdependent.<sup>35</sup> In these dilemmas, a noncooperative equilibrium yields payoffs that are inferior to the payoffs the players could receive by trusting one another to cooperate.<sup>36</sup> Consider, for example, the following one-shot social dilemma game. The game consists of two players who do not know each other's identity, and the game is played over the computer to retain each player's anonymity. At the beginning of the game, Player 1 receives ten dollars from the computer. She can keep all ten dollars or give some portion of it to Player 2. Any amount of money contributed to Player 2 is tripled for Player 2. Player 2 then decides whether to keep all of the proceeds or to send some back to Player 1. Then the game ends. This game has been dubbed "The Trust Game" because it was designed to test the extent to which Player 1 will risk reduced proceeds in order to increase the size of the total proceeds available to the two players.<sup>37</sup>

Game theorists would predict that a rational actor in Player 1's position would contribute nothing to Player 2.<sup>38</sup> In fact, individuals who actually play the social dilemma games tend to behave quite differently from the game theorists' predictions, often sending money back to their counterparts.<sup>39</sup> Indeed, as social dilemma games are made more realistic, cooperation rates rise significantly.<sup>40</sup> Moreover, the degree of both contributing and reciprocating is affected by culture, communication, and the number of rounds of play.<sup>41</sup>

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34. See generally TRUST AND RECIPROCITY, *supra* note 15.

35. See Ostrom, *supra* note 15, at 19–20.

36. *Id.*

37. Joyce Berg et al., *Trust, Reciprocity and Social History*, 10 GAMES AND ECON. BEHAV. 122 (1995).

38. See Elinor Ostrom & James Walker, *Introduction*, in TRUST AND RECIPROCITY, *supra* note 15, at 3.

39. See, e.g., Ostrom, *supra* note 15, at 49; Bruno S. Frey & Iris Bohnet, *Cooperation, Communication, and Communitarianism: An Experimental Approach*, 4 J. POL. PHIL. 322 (1996); Kevin McCabe et al., *Game Theory and Reciprocity in Some Extensive-Form Bargaining Games*, 93 PROC. NAT'L ACAD. SCI. 13421, Economic Sciences (Nov. 1996); John M. Orbell & Robyn M. Dawes, A "Cognitive Miser" Theory of Cooperators' Advantage, 85 AMER. POL. SCI. REV. 515 (1991) [hereinafter Orbell & Dawes, *Cognitive Miser Theory*]; John M. Orbell & Robyn M. Dawes, *Social Welfare, Cooperators' Advantage, and the Option of Not Playing the Game*, 58 AMER. SOCIOL. REV. 787 (1993); Rudolf Schuessler, *Exit Threats and Cooperation Under Anonymity*, 33 J. CONFLICT RESOL. 728 (1989); Toshio Yamagishi, *Seriousness of Social Dilemmas and the Provision of a Sanctioning System*, 51 SOC. PSYCHOL. Q. 32 (1988).

40. See Ostrom, *supra* note 15, at 49 (discussing studies).

41. Nancy R. Buchan et al., *Let's Get Personal: An International Examination of the Influence of Communication, Culture, and Social Distance on Other Regarding Preferences*, 60(3) Journal of Economic Behavior & Org. 373 (in press); John Dickhaut et al., *Trust, Reciprocity and Interpersonal History: Fool Me Once, Shame on You, Fool Me Twice, Shame on Me*, (Univ. of Ariz., Econ. Sci.

These experiments are important, especially insofar as they indicate that cooperation among strangers is higher than many, particularly economists, expect.<sup>42</sup> But how much do they tell us about real-world trust assessments? The experiments indicate that something *akin* to trust can, and often does, occur between *strangers who have few prior beliefs about each other that might inform the trust assessment at issue*. But in many, if not most, important real-world contexts, a trust assessment is informed by prior beliefs. Certainly, this is so in the common situation where people are *not* strangers to one another.<sup>43</sup> In many contexts, people will have prior beliefs even about *strangers*—based, for instance, on reputation or on the stranger’s job or social standing—that may inform their trust assessments about those strangers.<sup>44</sup> The extent to which the experimental findings help us understand the role of trust may therefore be limited. Indeed, as discussed in the next Part, the social dilemma games have contributed to the misimpression on the part of legal scholars that trust and distrust represent two opposite ends of a single dimension of human relationships. That misperception can cause us to make errors in drawing legal policy implications. We turn now to this final difficulty, saving the others for elaboration in Part III.

### *B. Differing Dimensions: Trust and Distrust*

Excessive reliance on social dilemma games has caused legal scholars to misunderstand the relationship between trust and distrust. In the social dilemma experiments, cooperation rather than trust is measured, but trust is assumed to be the driving force behind a player’s decision to contribute some amount of money to another player.<sup>45</sup> Moreover, trust and distrust

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Lab., working paper 1995), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=55450](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=55450).

42. Trust scholars have relied heavily on these social dilemma experiments to claim that the rational actor model is significantly limited. See Blair & Stout, *supra* note 12, at 1768–80; see also Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71 (2003).

43. Some scholars question whether economists are correct to call cooperation as studied in these experiments “trust” in the same sense that lay people might understand the term; some argue that trust is importantly, and perhaps even paradigmatically, an attribute of relationships among nonstrangers. See, e.g., HARDIN, *supra* note 3, at 26 (criticizing game theoretic work on trust as of limited usefulness in understanding trust as a relational concept). See also Hardin, *Conceptions*, *supra* note 21, at 3 (“it is primarily those with whom we have ongoing relationships that we trust”).

44. As to the biasing effects of prior information about a person’s character, see Maurice Delgado et al., *Perception of Moral Character Modulate the Neural Systems Of Reward During the Trust Game*, NATURE NEUROSCIENCE, Nov. 2005, at 1611.

45. The assumption is often embedded in the definition of “trust.” See Roy J. Lewicki et al., *Trust and Distrust: New Relationships and Realities*, 23 ACAD. MGMT. REV. 438, 440 (1998) (“Behavioral decision theorists, examining trust and distrust from a rational choice perspective, define

are assumed to lie along a unidimensional continuum, where the degree of trust is represented by the amount that a Player 1 is willing to send to her Player 2.

Recently, however, work on the relationship between trust and distrust calls the validity of the unidimensional characterization into question.<sup>46</sup> Under this alternative view, trust and distrust can, and often do, coexist. Trust involves positive expectations about things hoped for; distrust involves positive expectations about things feared.<sup>47</sup> Thus, low trust is not equivalent to high distrust, and low distrust is not the equivalent of high trust.<sup>48</sup> While strong feelings of trust can mitigate feelings of distrust and vice versa, parties in a relationship often maintain simultaneous feelings of trust and distrust about each other.<sup>49</sup> The primary proponents of this view, Lewicki et al., provide the following example:

I may get to know a . . . colleague . . . fairly well. Over time, I may learn that [he] is excellent as a theoretician, adequate but not exceptional as a methodologist, highly limited in skills as a classroom teacher, completely at odds with me in his political beliefs, outstanding as a golfer, tediously boring in committee meetings but periodically quite insightful, and terrible at keeping appointments on time. . . . With an appreciation of the richness of our relationship and the varied facets of my colleague's "presentations of self," I can come to understand and appreciate those domains where it is appropriate for me to trust him (and in what respects) and those domains where trusting him is inappropriate.<sup>50</sup>

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trust as cooperative conduct and distrust as noncooperative conduct in mixed-motive game situations.").

46. *Id.*

47. *Id.* at 439.

48. See also HARDIN, *supra* note 3, at 90 ("If I trust you, I have specific grounds for the trust. In parallel, if I distrust you, I have specific grounds for the distrust. I could be in a state of such ignorance about you, however, that I neither trust nor distrust you.").

49. See Lewicki et al., *supra* note 45, at 440–42.

50. *Id.* at 442.

Table 1 below sets forth Lewicki’s framework:

TABLE 1<sup>51</sup>  
 INTEGRATING TRUST AND DISTRUST: ALTERNATIVE SOCIAL REALITIES

<b>High Trust</b> Characterized by Hope Faith Confidence Assurance Initiative	High-value congruence Interdependence promoted Opportunities pursued New initiatives	Trust but verify Relationships highly segmented and bounded Opportunities pursued and down-side risks/vulnerabilities continually monitored				
	<table border="1"> <tr> <td>2</td> <td>4</td> </tr> <tr> <td>1</td> <td>3</td> </tr> </table>	2	4	1	3	
2	4					
1	3					
<b>Low Trust</b> Characterized by No hope No faith No confidence Passivity Hesitance	Casual acquaintances Limited interdependence Bounded, arms-length transactions Professional courtesy	Undesirable eventualities expected and feared Harmful motives assumed Interdependence managed Preemption; best offense is a good defense Paranoia				
	<b>Low Distrust</b> Characterized by No fear Absence of skepticism Absence of cynicism Low monitoring No vigilance		<b>High Distrust</b> Characterized by Fear Skepticism Cynicism Wariness and watchfulness Vigilance			

To Lewicki et al., trust relationships fall in one of the four cells reproduced in Table 1. Relationships tend to start in Cell 1 where the parties have limited information about one another and limited interdependence.<sup>52</sup> In Cell 1, the parties have little reason to form generalized conclusions about whether trusting or distrusting the other is

51. Reprinted from Lewicki et al., *supra* note 45, at 445.

52. The textual statements reflect the views of Lewicki et al. regarding relationship development. We argue later that, contrary to their presentation, some types of relationships start in Cells 2 and 3, and, as a consequence, the parties in those relationships are prone to inaccurately assess trust-relevant information.



appropriate. Situational variables (external factors affecting “trust that” assessments) and default trust rules (individual propensities to trust) will play a relatively large role in the individual’s trust decisions.

Over time and with consistent repeat interactions, the relationship should gravitate toward one of the other cells. If the interactions are generally positive over time, then the relationship can evolve into one of low distrust and high trust as described in Cell 2. Individuals who are operating in a Cell 2 relationship often seek out new ways to interact with one another. According to Lewicki et al., these parties are motivated to resolve tensions and repair trust problems as they arise.<sup>53</sup> Moreover, subsequent evidence of the untrustworthiness of the other is likely to be minimized and denied.<sup>54</sup>

If instead the parties’ interactions are generally negative over time, then their relationship likely gravitates to Cell 3, which is characterized by low trust and high distrust. These individuals attempt to limit their interactions, and when they must interact, they devote considerable resources to monitoring one another and protecting themselves against exploitation by the other.<sup>55</sup> Conversations are cautious, guarded, and often disingenuous.<sup>56</sup>

Last, but certainly not least important, are the Cell 4 relationships, which have been ignored in previous trust literature.<sup>57</sup> These parties have high confidence in one another with regard to certain aspects of their relationship and yet have reason to be wary of one another in other respects.<sup>58</sup> In these relationships, the individuals have both shared and separate, conflicting goals. With regard to their shared goals, trust is reflexive. Where their goals conflict, however, monitoring and at least slight guardedness are common. The coexistence of trust and distrust presumably can stem from several causes, including differing motives for behavior, the coexistence of strengths and weaknesses in people’s talents, and differing cost-benefit structures of varying contexts. According to Lewicki et al., this ambivalent relationship “is the most prevalent for multiplex working relationships in modern organizations.”<sup>59</sup>

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53. See Lewicki et al., *supra* note 45, at 446.

54. *Id.* See *infra* Part III.C for further description of this “disconfirmation bias.”

55. *Id.*

56. *Id.* at 447.

57. *Id.*

58. See also HARDIN, *supra* note 3, at 97 (discussing society with high personal distrust and yet extensive trading as one where in reality individuals trust one another with respect to some matters but not others).

59. Lewicki et al., *supra* note 45, at 447.

Lewicki's framework carries with it considerable intuitive appeal. Trust and distrust can, and often do, coexist in relationships. Individuals often are capable of fine-tuning both their impressions of one another and their cooperation with one another. Information that indicates that another is (un)trustworthy in one context can, but need not, affect one's view about whether the other is (un)trustworthy in different contexts. Indeed, as we discuss in the next Part, trust is not nearly as fragile as some legal scholars have argued.<sup>60</sup> Although trust sometimes can erode more quickly than it is created, trust in some contexts may be quite resilient. Moreover, we might expect blunt distrust-creating tools to damage surrounding trust more than more precise tools. Indeed, the beneficial aspects of trust in relationships may be more immune to legal measures that create specific fine-tuned and carefully targeted forms of distrust than legal scholars have previously supposed.<sup>61</sup>

Both trust and distrust in relationships can prove beneficial; law should therefore promote "optimal trust." When is trust apt to be nonoptimal? In short, trust is apt to be nonoptimal where it does not develop slowly, is not subject to a careful vetting process, and/or does not respond effectively to disconfirming trust-relevant information. Returning to Lewicki et al.'s framework, people are perhaps starting in Cells 2 and 3, rather than Cell 1. Whatever their starting point may be, we suspect that they are not updating accurately. Indeed, it may be true more generally that trust in the Cell 2 and 3 relationships is more apt to operate heuristically and without regard to disconfirming information. In contrast, trust assessments by people in Cell 1 and Cell 4 relationships seem to more often involve careful analytic processing of available information. In those types of relationships where people are inclined to systematically trust one another too much or too little and are systematically inclined to process trust information heuristically, then legal interference seems most appropriate and most likely to prove useful. We turn to a fuller consideration of this matter in Part III below.

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60. See, e.g., Blair & Stout, *supra* note 12, at 1776; Leslie, *supra* note 13, at 545; Paul Slovic, *What's Fear Got To Do With It? It's Affect We Need To Worry About*, 69 MO. L. REV. 971, 988 (2004); Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. L. 869, 870 (1999); see also Robert Gatter, *Faith, Confidence and Health Care: Fostering Trust in Medicine Through Law*, 39 WAKE FOREST L. REV. 395, 402 (2004) (noting received wisdom among scholars that trust is fragile). We discuss the resilience of trust *infra* in Part III.C.

61. See Lewicki et al., *supra* note 45, at 448 ("[I]t would be extremely misleading to assume either that the positive predictors of trust would necessarily be negative predictors of distrust or that the positive consequences of trust would necessarily be influenced negatively by increased distrust.").

### III. NONOPTIMAL TRUST

In this Part, we try to identify some of the factors that might lead the trustor in particular relationships to trust the other at nonoptimal levels and explore some of the cognitive mechanisms that can contribute to the problem. To some extent, we are able to rely on existing trust literature, but much of our framework consists of our attempts to apply more general theories of cognitive psychology to the trust context. In these latter cases, we introduce hypotheses that we believe are highly plausible but would need to be tested to confirm that they in fact work the way we suggest in the context of trust. In Part III.A, we introduce the possibility that overtrust and undertrust can evolve as rational responses to uncertainty regarding the optimal level of trust in a given situation. Given the role of trust in reducing perceived uncertainty, however, initial errors in trust assessments are sometimes not readily amenable to subsequent revision. In Part III.B, we focus on the fact that some trust assessments are made consciously while others operate at a subconscious level. Although neither conscious nor subconscious trust assessments are immune from the effects of cognitive biases, the latter trust assessments may be more prone to them. In Part III.C, we explore the influence that trust emotions have on the cognitive processing of the risks associated with trusting another. In some cases, trust emotions block rational assessments of the advisability of trusting another. We conclude with a summary and some thoughts about how these cognitive phenomena influence trust decisions in particular contexts.

#### *A. Trust Biases as Error Management*

To develop a cognitive theory of trust, we first need a better understanding of the role of trust for humans. Why do people trust or distrust one another? Put differently, why do people adopt positions of *confidence* in their assessments of the actions and/or intentions of others?<sup>62</sup>

We sometimes need to make a binary decision as to whether to trust. Should a shopkeeper close his store when he goes on vacation, or should he let his assistant keep the store open in his absence? The shopkeeper may very well think it is likely that the assistant can be trusted, but he

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62. Confidence seems to be an essential component of the definition of trust, as is apparent in the Oxford English Dictionary's definitions of trust. See OXFORD ENGLISH DICTIONARY, 2d ed., vol. 18, at 623–25 (1989).

cannot be completely sure. The assistant's actions would turn on a combination of perhaps unknown factors, including the assistant's internal normative commitment to be trustworthy, his current financial needs, the likelihood that he could get an equivalent or better job elsewhere, and the extent to which he will suffer legally or reputationally if he steals from the shopkeeper. Unfortunately, however, uncertainty does not sit well with us humans.<sup>63</sup> Ultimately, the shopkeeper must decide whether to trust his assistant with his register, and he needs to stop worrying about whether he has made the correct decision.

To some trust scholars,<sup>64</sup> decisions about trust and distrust serve to enable people to "contain and manage social uncertainty and complexity."<sup>65</sup> Trust reduces the assessor's sensation of uncertainty and complexity by enabling her to believe that the possibility of harm is lower and the likelihood of beneficial conduct is high. Conversely, distrust causes the assessor to increase—perhaps to near certainty—her sense that the other person will act in a harmful way while simultaneously reducing in her mind the possibility that beneficial results will follow from trusting. This tendency for trust to bias perceptions is a specific example of a more common tendency to use mental shortcuts that enable decisive action.<sup>66</sup>

Trust, then, can be viewed as a cognitive phenomenon that serves the assessor's need to act decisively in the face of uncertainty. This need to make and act on a decision does not necessarily create nonoptimal trust because the evaluator often can cabin the degree to which she makes herself vulnerable in response to his initial assessment. Returning to our roadside produce stand, for example, the farmer might choose to leave the produce unmanned but to lock down the cash box. Put differently, one common mechanism by which the evaluator can remain confident about her trust assessment is to break down the differing facets in which trust

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63. See Richard A. Posner, *The Jurisprudence of Skepticism*, 86 MICH. L. REV. 827, 873 (1998) ("[P]eople hate being in a state of doubt and will do whatever is necessary to move from doubt to belief.") (citing C. Peirce, *The Fixation of Belief*, in PHILOSOPHICAL WRITINGS OF PEIRCE 5, 10 (J. Buchler ed., 1955)).

64. See Lewicki et al., *supra* note 45, at 444 (citing N. LUHMANN, TRUST AND POWER (1979)).

65. *Id.*

66. See Martie G. Haselton et al., *The Evolution of Cognitive Bias*, 6 (draft manuscript on file with author 2004) (discussing heuristics as enabling people to make fast decisions when needed).

[B]eing able to reduce a welter of information to a manageable size has attractions even if we know that the basis of that reduction is flawed. Most of us prefer to develop a basis for action, rather than simply to contemplate the many-splendoured diversity of the world around us. Rushing fools more often make mistakes, but the virtues of angelic caution are not appealing to most.

Good, *supra* note 24, at 40.

might be relevant to her actions and to choose to trust only to the extent consistent with her trust-relevant information.<sup>67</sup> To the extent that fine gradations can be made in the evaluator's decision to make herself vulnerable to other's predation, relatively optimal trust decisions can be made. That is, assessments may be biased, but the costliness of the consequences of trust is carefully contained by taking small steps with respect to vulnerability.<sup>68</sup>

Unfortunately, fine vulnerability gradations are not always available to a decision maker. If, for example, the shopkeeper must decide whether to book his fishing trip two hours after hiring his assistant, he must make a big decision with little "trust in" information, and he might well end up having overtrusted or undertrusted. Indeed, because the decision is binary—he will entrust his assistant with the store or he will not—any assessment he makes will almost certainly constitute a leap from the information he has available to him. Where trust decisions are lumpy, either because they must be made too soon or because the vulnerability of the truster is discontinuous, the cognitive bias necessarily embedded in the trust decision can prove costly. How does the individual end up deciding whether to trust? In many contexts, we would expect that decision to comport with the Error Management Theory of cognitive bias.<sup>69</sup>

According to Error Management Theory (EMT), social judgments are inevitably susceptible to error due to the realities of imperfect information and others' deceptive efforts.<sup>70</sup> In the face of this uncertainty, we run the risk of erring in one direction or the other, and EMT predicts that when the relative costliness of the two types of error differ, the optimal system will be biased toward committing the less costly error.<sup>71</sup> From an evolutionary perspective, the costlier the error to those individuals who make it, the less

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67. Cooperative steps often start out small. When, for example, Palo Alto homeowners were asked to place large signs in their yards asking others to drive slowly, the vast majority refused. When they were instead asked to put a small sign on their cars or to sign a petition, the vast majority agreed to cooperate. After taking this smaller step, most of the homeowners were prepared to place the larger sign in their yards (the percentage of cooperating homeowners increased from 17 to 76). Katyal, *supra* note 13, at 1349.

68. Consider in this regard HARDIN, *supra* note 3, at 124, who says that "[i]t seems likely that one will tend initially to trust a new person only in limited ways and will trust on more important matters only after building up to them."

69. Martie G. Haselton & David M. Buss, *Error Management Theory: A New Perspective on Biases in Cross-Sex Mind Reading*, 78 PERSONALITY & SOC. PSYCHOL. 81 (2000).

70. Errors might also be affected by the fact that heuristics and rules of thumb are common mechanisms by which humans economize on cognitive effort. Orbell & Dawes, *supra* note 40, at 517.

71. Martie G. Haselton & David M. Buss, *Biases in Social Judgment: Design Flaws or Design Features?*, in RESPONDING TO THE SOCIAL WORLD: IMPLICIT AND EXPLICIT PROCESSES IN SOCIAL JUDGMENT AND DECISIONS 23, 30 (J. Forgas, K. Williams & B. Von Hippel eds., 2003).

likely the individual is to gain in relative fitness.<sup>72</sup> Selection can therefore favor a cognitive bias that produces more errors so long as the magnitude of the costs of those errors is smaller than that associated with the alternative bias.<sup>73</sup> The common, though unfortunate, tendency of people to avoid diseased or injured people might provide an example of EMT at work.<sup>74</sup> “[T]he false negative (failing to avoid someone with a contagious disease) is highly costly, whereas the false positive (avoiding contact with a noncontagious person) may be inconvenient but is unlikely to be injurious.”<sup>75</sup> This bias might be involved as well in the recent widespread panic over SARS, Mad Cow Disease, and AIDS contamination, even though these risks are comparatively slight in the United States.<sup>76</sup> This suggests that EMT can be applied to at least some trust decisions because (1) they involve uncertainty; (2) the costliness of making an incorrect trust assessment can be quite large; and (3) the aggregate costs of overtrust and undertrust are at times asymmetric.<sup>77</sup>

To fully appreciate how EMT might apply to trust behavior, we must more carefully elaborate on the contributions of behavioral biology to human psychology. Behavioral biologists treat the brain as a human organ subject to the same evolutionary pressures as our other organs.<sup>78</sup> Because cognition and social judgment are both products of our brain processes, evolutionary theory suggests that cognitive biases are themselves a product of evolutionary pressures.<sup>79</sup> These evolutionary pressures work slowly, however; it can take many generations for the brain’s cognitive processes to adapt to important environmental changes.<sup>80</sup> EMT presupposes that cognitive biases are a response to environmental

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72. Haselton et al., *supra* note 66, at 10.

73. *Id.* at 31.

74. Haselton et al., *The Evolution of Cognitive Bias*, in DAVID M. BUSS, *THE EVOLUTIONARY PSYCHOLOGY HANDBOOK* 724, 734 (David M. Buss ed., 2005). Studies indicate that little evidence is required to convince someone that another is ill or contagious, whereas much stronger evidence is often necessary to convince others that another is free from disease. Even though this bias leaves its possessor prone to make errors about whether others should be avoided, it biases the interaction decision in favor of making the least costly error. *Id.*

75. *Id.*

76. *Id.*

77. Haselton & Buss, *Biases in Social Judgment*, *supra* note 71, at 31.

78. See TIMOTHY H. GOLDSMITH, *THE BIOLOGICAL ROOTS OF HUMAN NATURE: FORGING LINKS BETWEEN EVOLUTION AND BEHAVIOR* 91 (1991); Owen D. Jones, *Time-Shifted Rationality and the Law of Law’s Leverage: Behavioral Economics Meets Behavioral Biology*, 95 NW. U. L. REV. 1141, 1143 (2001).

79. See Jones, *supra* note 78, at 1165.

80. *Id.* at 1167–68 (noting significant time lag between environmental change and the human brain’s adaptation to that change).

pressures that existed in the environment of evolutionary adaptation (or EEA) rather than in response to modern pressures.<sup>81</sup>

What might trust biases look like under EMT? Sometimes, EMT would lead to overtrust; other times, it should lead to undertrust. We expect overtrust<sup>82</sup> in small stakes, one-shot transactions.<sup>83</sup> It is now commonly believed that in the EEA where our brains evolved, humans lived in small groups.<sup>84</sup> In that world, an interaction with another human carried with it the significant likelihood that the interaction would repeat itself in the not-too-distant future.<sup>85</sup> The net potential gains from cooperation were therefore significant, and, more importantly, greater than the net potential gains from defecting. The EMT prediction of overtrust in one-shot games is borne out<sup>86</sup> and contrasts with that of economists, who predict distrust as a consequence of anticipated defection.<sup>87</sup> The same is, of course, not true

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81. *Id.* at 1167–68. Jones' related "time-shifted rationality" hypothesizes that many of the cognitive errors identified by behavioral theorists today were actually "rational" behaviors in the period in which our brains evolved. *Id.* at 1171–73. Put differently, humans who possessed such qualities as a taste for sweets, an ability to understand frequencies (rather than probabilities), and a tendency to steeply discount the value of future events, were more likely to survive and thrive than were humans who did not possess them, even though these qualities may be problematic, and even harmful, today. See Jones, *Time-Shifted Rationality*, *supra* note 78, at 1174–75 (taste for sweets), 1179–81 (frequencies), 1177–79 (discounting). See also GERD GIGERENZER, *ADAPTIVE THINKING: RATIONALITY IN THE REAL WORLD* (2000). In contrast to time-shifted rationality, EMT does not claim that these cognitive biases were ever "rational" in the sense that the decisions themselves were perfectly made in the EEA. Rather, they are second-best systemic responses to the inevitability of errors in social judgments in the EEA.

82. Recall that overtrust and undertrust are measured as a function of whether trust assessments turn out to be correct. We do not mean to suggest by the textual sentence that we believe as a normative matter that people should trust each other less in this context.

83. For applications of EMT to cooperation in one-shot games, see T. Yamagishi et al., *The Social Exchange Heuristic: Managing Errors in Social Exchange* (2003) (unpublished manuscript); T. Yamagishi et al., *Bounded Generalized Reciprocity: In-group Favoritism and In-group Boasting*, 16 *ADVANCES IN GROUP PROCESSES* 161 (1999).

84. See, e.g., MATT RIDLEY, *THE ORIGINS OF VIRTUE* 69 (1997) (relationship between size of neocortex relative to rest of brain and size of animal social groups suggests that humans evolved in groups averaging 150 in number); PAUL H. RUBIN, *DARWINIAN POLITICS: THE EVOLUTIONARY ORIGIN OF FREEDOM* 7 (2002) (available evidence suggests that social group size for humans in the EEA ranged between 25 and 150).

85. See, e.g., Robert Kurzban, *Biological Foundations of Reciprocity*, in *TRUST AND RECIPROcity*, *supra* note 15, at 105, 119 ("Our ancestors were probably engaged in a repeated game with virtually everyone in their local environment.").

86. Even when subjects are placed in an iterative context without communication, cooperation in the first few rounds is common, and apparently reflexive; cooperation rates only tend to drop off in the final few periods. Ostrom, *supra* note 15, at 28–29. Apparently, then, iterative plays focus the players on "rational" end game strategies whereas one-shot games seem to focus the players on generalized instinctive (and perhaps ethical) considerations. *Id.*

87. *Id.* Indeed, economists sometimes assume that because somebody who trusts reaps only part of the benefits of cooperation yet incurs all of the costs of the other's opportunism, people generally are inclined to undertrust. See HARDIN, *supra* note 3, at 82 ("If . . . trustworthiness . . . is a collective

where the stakes are higher: trusting an acquaintance to reciprocate your hunting efforts might be one thing, but trusting that person with your baby's care might be quite another. Under EMT, therefore, when there were contexts where erroneously trusting was potentially more costly than erroneously not trusting, then we would expect undertrust.<sup>88</sup>

EMT also predicts undertrust (indeed, distrust) of people we consider to be of other groups,<sup>89</sup> and overtrust of people we consider to be of our own group. “[H]umans appear to possess a bias toward inferring that members of competing coalitions (or out-groups) are less generous and kind . . . and more dangerous and mean . . . than are members of their own group.”<sup>90</sup> In-group favoritism often results from a greater propensity to trust those who are similar to oneself in background or values. For example, Janet Landa interviewed Chinese rubber dealers to learn more about how they choose their trading partners.<sup>91</sup> Because the merchants felt unable to rely on contract law to enforce their contracts, they ranked potential trading partners according to trustworthiness and attempted to limit their transactions to the groups of individuals deemed more

good, there may be a tendency to underinvest in it, as there may be a tendency to underinvest in reputation.”).

88. Haselton et al., *supra* note 74, at 15, discuss this idea in the context of cooperation rather than trust. When the costs of cooperation are relatively low or the social costs of failing to cooperate, through ostracism or otherwise, are potentially high, then they predict greater cooperation. *Id.*

89. Besides the obvious triggers of in-group identification (race, ethnicity, social class, etc.), it is also possible to sporadically trigger in-group sentiments and behavior with less trivial categories. For example, when experimenters group subjects together by the first digit in their social security numbers, those with the same numbers give each other higher payoffs than they give those with different numbers. *See generally*, HENRY TAJFEL, *SOCIAL IDENTITY AND INTERGROUP RELATIONS* (1982). Moreover, “placing groups into competition has been shown to increase intergroup bias in the allocation of benefits and in the evaluation of out-group performance.” Linda Hamilton Krieger, *Civil Rights Perestroika: Intergroup Relations After Affirmative Action*, 86 CAL. L. REV. 1251, 1274–75 (1998); *see also* Bernard M. Bass & George Duntzman, *Biases in the Evaluation of One's Own Group, Its Allies and Opponents*, 7 J. CONFLICT. RES. 16 (1963); Marilyn B. Brewer & Roderick M. Kramer, *The Psychology of Intergroup Attitudes and Behavior*, 36 ANN. REV. PSYCHOL. 219, 227 (1985).

90. Haselton et al., *supra* note 74, at 737 (citing Marilyn B. Brewer, *In-group Bias in the Minimal Intergroup Situation: A Cognitive-Motivational Analysis*, 86 PSYCHOL. BULL. 307 (1979), and Lincoln Quillian & Devah Pager, *Black Neighbors, Higher Crime? The Role of Racial Stereotypes in Evaluations of Neighborhood Crime*, 107 AM. J. SOC. 717 (2001)). Using EMT reasoning, this distrustful bias can be explained as follows:

For ancestral humans, the costs of falsely assuming peacefulness on the part of an aggressor were likely to outweigh the comparatively low costs of elevated vigilance toward aggression, especially for inferences regarding out-group members. For in-group members, elevated inferences of aggressiveness would have caused the additional costs of within-coalition conflict; hence the negative bias might be expected to be small or nonexistent for in-group members.

*Id.* at 737.

91. Janet T. Landa & Xiao Tian Wang, *Bounded Rationality of Economic Man: Decision Making Under Ecological, Social and Institutional Constraints*, 3 J. BIOECONOMICS 217 (2001).



trustworthy. Kinsmen in the same nuclear family topped their list, followed by extended-family kinsmen, then clansmen, then fellow villagers, then Chinese persons speaking the same dialect, then Chinese speaking another dialect, and finally non-Chinese.<sup>92</sup> Landa quotes a rubber merchant as saying, “[b]ecause of the risk involved in advancing money without security, based purely on trust, we tend to trade with those whom we trust; they are often kinsmen, friends, people from the same place in China and those who speak the same dialect.”<sup>93</sup> “Beyond the Hokkein-Chinese ethnic boundary, the limits of Confucian ethics form the basis for a Hokkien-Chinese trader’s classification of all potential traders into two major categories, ‘the insiders’ (i.e. Hokkiens); and ‘outsiders’ (non-Hokkiens, and non-Chinese). The insiders, because of shared Confucian social norms of behavior, are seen as members of a ‘moral community’ of reliable trading partners.”<sup>94</sup>

Trust biases, whether or not explained by EMT, are in part made possible by two related but distinct features of trust. First, not all trust decisions are consciously made, and subconscious cognitive processes, because they fail to correct cognitive biases, may be more susceptible to error. Second, some trust decisions are of a sort we call “specific trust,” whereas others are made by reference to residual and more generalized feelings of trust or distrust toward the other person. These more generalized bases for trust decisions tend to be less accurate than specific trust reasoning. This inaccuracy is exacerbated by the fact that residual trust is more likely than specific trust to generate subconscious trust decisions. We now turn to explore these phenomena.

### *B. Conscious vs. Subconscious Trust Assessments*

Many trust scholars define trust as conscious, or deliberate, decision-making.<sup>95</sup> In actual life, however, we often trust others and act in a

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92. *Id.* at 228; see also Toshio Yamagishi & Midori Yamagishi, *Trust and Commitment in the United States and Japan*, 18 MOTIVATION & EMOTION 129 (1994) (finding that Japanese subjects tend to trust one another within but not across cliques).

93. Landa & Wang, *supra* note 92, at 227.

94. *Id.* at 228–29.

95. See, e.g., Blair & Stout, *supra* note 12, at 1746 (“[T]he trusting actor must deliberately make herself vulnerable to the trusted actor . . . .”); *id.* at 1746 n.18 (“Trust thus implies volition on both sides.”); Dunn, *supra* note 27, at 73 (defining trust as “a more or less consciously chosen policy for handling the freedom of other human agents or agencies”); Ostrom & Walker, *supra* note 38, at 6 (“[a] core aspect of most definitions of trust is the (intention to accept vulnerability). . . .”; Rosseau et al., *supra* note 18, at 395 (defining trust as “a psychological state comprising the intention to accept vulnerability based on positive expectations of the intentions or behavior of another”).

trustworthy fashion without being conscious of making a decision. In long-term relationships we can be incited to anger when another fails to act in a trustworthy fashion. “I trusted you!” the betrayed individual cries indignantly. In these cases, the angry person is upset in part because she did not think it necessary to worry about whether the untrustworthy person would act in her interests. Trust, in both our personal and professional lives, is important for many reasons, one of which is that it obviates the constant calculation about whether trust is warranted. Indeed, very few people constantly calculate whether they can trust. We don’t leave faculty meetings wondering whether a colleague has stolen our umbrella. When we ask a stranger for directions, we rarely wonder whether her answer was honest. And we don’t worry about whether the babysitter is really a spy working for the CIA. Our quality of life would be impoverished and we would be paralyzed if we had to consciously calculate all possible trust assessments. Many, and perhaps most, people in their ordinary day-to-day interactions take the default position to act in a trusting fashion with others unless and until they receive cues that distrust might instead be appropriate. Only when there are sufficiently large clues that distrust may be appropriate (or when the stakes are sufficiently high) does a conscious decision about trust come into play.<sup>96</sup> Put differently, there are individual processes that generate propensities to trust others; these quite often are not carefully calculated, or even conscious. In this sense, they are automatic.

How might an automatic default trust assessment evolve? After all, those individuals who are trusting—who tend to make themselves vulnerable to others—can be exploited by untrustworthy individuals. The answer turns on a link between trusting and trustworthy behavior. There are evolutionary advantages to being trustworthy: the trustworthy individual has more trading, friendship, and other personal opportunities than the untrustworthy individual. And being trusting has become a credible signal of trustworthiness. As an empirical matter, people who are more instinctively trusting of others also tend to be more trustworthy and

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96. Of course, there is significant individual variation in people’s willingness to trust others as a subconscious default. A paranoid person might never subconsciously decide to trust another. A low-trust individual will calculate rational moves sooner than a high-trust person. And an extremely naïve individual might trust even in the face of unambiguous external stimuli suggesting that trust is inappropriate. Under this conception, then, individuals fall along a trust spectrum depending on their sensitivity to disconfirming external evidence and the presence of incentives that might cause them to focus consciously on making a rational trust decision.

vice versa.<sup>97</sup> Conversely, people who are less trustworthy are less likely to trust others.<sup>98</sup> This observation accords with intuition: people readily imagine others behaving as they themselves would behave, an observation that underlies the leading cognitive science theory of mind.<sup>99</sup>

Being trustworthy yields instrumental benefits, but the personally committed trustworthy individual is trustworthy without regard to these benefits. And the very fact that the benefits are not calculated or motivating the trustworthiness is what gives the trustworthy individual his advantage.<sup>100</sup> After all, a person who will be trustworthy regardless of the costs is a much better trading and mutual support partner than one who is only contingently trustworthy. “The fact that trustworthy persons *do* receive a material payoff [in the form of more extensive interactive opportunities] is of course what sustains the trait within the individual selectionist framework.”<sup>101</sup>

Because trustworthy people also tend to be more trusting, they are more likely themselves to seek out opportunities for reaping cooperative gains.<sup>102</sup> Those who are too trusting quickly learn from their experiences that they need to readjust their levels of trustworthiness. Individuals who trust too little, by contrast, tend to avoid interactions with strangers because they tend to think that others cannot be trusted to make those interactions successful. These individuals might have the capacity to become more trustful of others, but their less frequent interactions provide them with slower and weaker evidence that trust adjustments are in order.<sup>103</sup>

When trustworthy people encounter one another, they can reap the material benefits of exchange as well as the emotional benefits of being in a mutually trusting relationship. As mentioned earlier, however, trusting and trustworthy individuals can be exploited by untrustworthy individuals. In order to reap net benefits from trusting behavior, then, trusting

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97. Blair & Stout, *supra* note 12, at 1765–66; Peter Brann & Margaret Foddy, *Trust and the Consumption of a Deteriorating Common Resource*, 31 J. CONFLICT RES. 615, 622–23 (1987); John M. Orbell et al., *Do Cooperators Exit More Readily than Defectors?*, 78 AMER. POL. SCI. REV. 147 (1984); Julian B. Rotter, *Interpersonal Trust, Trustworthiness, and Gullibility*, 26 AMER. PSYCHOLOGIST 1, 2 (1980).

98. Blair & Stout, *supra* note 12, at 1765–66.

99. See, e.g., Alvin Goldman, *In Defense of Simulation Theory*, 7 MIND & LANGUAGE 104 (1992); Robert Gordon, *Folk Psychology as Simulation*, 1 MIND & LANGUAGE 158 (1986).

100. ROBERT H. FRANK, *PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS* 69 (1988).

101. *Id.*

102. See Orbell & Dawes, *Cognitive Miser Theory*, *supra* note 39, at 526.

103. This account of undertrust is provided in HARDIN, *supra* note 3, at 120.

individuals need to refrain from trusting others when they receive sufficiently potent signals that trust might be inappropriate. Therein lies the tension for the trusting individual. Under any self-interest based theory of trust, a person's signal receptivity must be sensitive enough to prevent her from incurring large costs from exploitation and yet dull enough to signal to others that she is a high-trust individual. Recall also that for most people, initial trust steps are small and provide a testing ground to determine whether the other person is trustworthy.<sup>104</sup> Small steps minimize the costs of nondiscriminating trust. This strategy enables trustworthy individuals to find one another while simultaneously weeding out untrustworthy individuals at relatively low cost.<sup>105</sup>

The important points here are that (1) many trust assessments are engaged in subconsciously; (2) trust tends to beget trustworthiness, whereas distrust tends to beget untrustworthiness; (3) in many contexts people tend to function with a default rule to trust; and (4) initial trusting steps will often be comparatively modest. Once a conscious trust assessment is triggered, though, the truster is likely to rely on a type of rational reasoning about her interests, through EMT or traditional cost-benefit analysis, and the likelihood that she will in fact trust is lowered.<sup>106</sup> Subconscious trust assessments may be more prone to error, because specific trust-relevant information is less likely to be taken into account during the assessment process. If subconscious trust assessments are routine in some contexts or in some types of relationships, then policymakers should worry about the possibility of systematically nonoptimal trust levels in those contexts and relationships. The problem of subconscious trust assessments is closely related to a second source of trust-assessment inaccuracy: an unwarranted focus on residual trust

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104. HARDIN, *supra* note 3, at 124 ("It seems likely that one will tend initially to trust a new person only in limited ways and will trust on more important matters only after building up to them".).

105. The statement in the text is a variant on geneticist John Maynard Smith's description of the Hawk/Dove game. In the game, Hawks are aggressive defectors and Doves are passive cooperators. When a Hawk encounters a Dove, the Hawk is able to exploit the Dove. When two Hawks encounter one another, they destroy one another. When two Doves encounter one another, they enjoy benefits. A successful strategy for Doves entails turning into a Hawk, or retaliating, when a Dove encounters a Hawk. John Maynard Smith & G.R. Price, *The Logic of Animal Conflict*, 246 NATURE 15 (1973). Given that retaliation can be costly, limited initial interaction followed by avoidance could be an equally successful strategy for Doves to weed out Hawks.

106. Interestingly, as implied in the text, trusting causes people to interact more often with others. Because trust begets trustworthiness, however, the trusting individual's more positive information may cause her to continue to trust at very high levels. In that case, however, the high truster could nevertheless accurately assess the trustworthiness of others as regards their behavior relative to her.

feelings at the expense of specific trust-relevant information.<sup>107</sup> We turn now to that subject.

### C. *Two Trust Boxes: The Case for Residual Trust*

Trust scholars have identified two very different types of trust. The first type of trust, which we will label “specific trust,” involves a belief or assumption that one can accurately predict how another will behave in a given situation.<sup>108</sup> Can I trust the painter to lock the door when he leaves? Can I trust my client in my office with confidential information in my files? Can I trust my dean to assign me the courses that I want to teach? At other times, trust is conceived of more broadly, as a “general positive attitude” that leads one to expect, believe, or assume that “another’s future actions will be beneficial, favorable, or at least not detrimental to one’s interests.”<sup>109</sup> This more general trust often “involves an inference about the ‘spirit’ or ‘motive’ that will shape behavior, [rather than a prediction about the] specific behavior [that] will occur.”<sup>110</sup> This more general trust is simply a trust that another will make good faith efforts to protect the truster’s interests, or a knowledge of the other’s values that the truster believes will inform the other’s actions in a particular way. The more general trust might well be, and typically is, a belief or attitude about a specific person that informs our general view of the person; it is in significant part what we have labeled “trust in” trust.<sup>111</sup>

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107. Admittedly, no general consensus supports the invariant superiority of more conscious assessments over more subconscious assessments. Indeed, a recent (and already quite influential) book by Malcolm Gladwell, *Blink*, argues for the value of quick decisions over those made with more deliberation. MALCOLM GLADWELL, *BLINK* (2004); see also George Loewenstein & Ted O’Donoghue, *Animal Spirits: Affective and Deliberative Processes in Economics Behavior* (2005) (working paper, on file with authors). In contrast to their work, however, we focus on these examples in which the subconscious assessment is in fact mistaken because over- or undertrust has invoked or exploited a cognitive bias, and a more deliberative assessment might very well catch the mistake.

108. Tom Tyler calls this trust “calculative trust.” Tom R. Tyler, *Trust and Law Abidingness: A Proactive Model of Social Regulation*, 81 B.U. L. REV. 361, 366 (2001). To avoid confusion with conscious trust decisions discussed earlier in this article, we refer to this type of trust as specific trust.

109. Sandra L. Robinson, *Trust and Breach of the Psychological Contract*, 41 ADMIN. SCI. Q. 574, 576 (1996); see also *id.* at 579 (“trust comes not from a cognitive calculus of how a particular party will act but, rather, from the relational bonds between the parties . . . and the implicit assumptions that others in one’s social relationships have respect and concern for one’s welfare”).

110. Tyler, *supra* note 108, at 366–67.

111. Consider in this regard Delgado et al., *supra* note 44. In their experiment, subjects were told about transacting partners who had done one of three types of actions, all of which were unrelated to the transaction at issue: a “good” action, a neutral action, and a “bad” action. The resulting reaction of the subjects indicated general, residual (dis)trust of the “good” and “bad” partners, trust that seemed to resist updating. By contrast, subjects more readily processed information relevant to the trustworthiness of the partner who had engaged in a morally neutral action.

We wish to suggest here that trust decisions can be made either on the basis of a general assessment or instead on the basis of a specific assessment, and that these two types of assessments utilize very different reasoning processes. Cognitive processing models in the psychology literature contemplate that people have two types of processing mechanisms: roughly, one is automatic and subconscious, and the other is deliberative and conscious.<sup>112</sup> We think trust decisions are sometimes made using more automatic, subconscious processes; at other times they are made using more deliberative processes. If the assessor is consciously attempting to predict how another will behave in a particular instance, her brain will seek a specific assessment about trust. If the truster lacks information about the specific behavior of the other or the specific context being assessed, her cognitive processes will instead produce a trust judgment based on her general sense about the trustworthiness of the other person. We will refer to this general sense about the trustworthiness of the other as the truster's residual trust in the other person. These differing cognitive processes can help to facilitate the coexistence of trust and distrust discussed in Part II. Individuals can and do hold information about specific trust and distrust which is different from their residual trust or distrust in the same person. For example, Sue might think Sam is generally trustworthy, but she may know from past experience that he's incapable of being punctual.

In general, this dual mechanism for trust-based decisions works well. A dual mechanism whereby residual trust forms the basis of assessments unless overridden by a conscious, specific trust assessment enables the brain to economize on resources. A person cannot focus on every possible context in which trust is relevant in every relationship that she maintains, and residual trust, which is largely subconsciously processed, frees up cognitive energy for other tasks. To help the individual to contain error costs, however, a specific trust processing mechanism often kicks in as needed to override residual trust.

Sometimes, however, the mechanism works less well. Information from the specific trust assessments should inform residual trust, but may

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112. See, e.g., *infra* notes 117–21 and accompanying text (discussing psychology literature that contrasts heuristic and deliberative thought processes). Of course, cognitive scientists have generated differing dual mechanism hypotheses. See, e.g., JOSEPH LEDOUX, *THE EMOTIONAL BRAIN* 164 (1996) (illustrating separate neural pathways for the processing of decision-relevant information); John R. Anderson, *Acquisition of Cognitive Skill*, 89 *PSYCHOL. REV.* 369 (1982) (arguing for declarative and procedural mechanisms for processing information relevant to a skill domain); Steven Sloman, *The Empirical Case For Two Systems of Reasoning*, 119 *PSYCHOL. BULL.* 3 (1996) (arguing for presence of associative and rule-based systems of reasoning).

do so imperfectly. Residual trust may be sticky, resisting revision notwithstanding contrary evidence. We may hold on to the belief that a relative is generally trustworthy notwithstanding the relative's tendency to be late in repaying debts and general unreliability in many other spheres. Consider in this regard the recent scandals involving Catholic priests. There was clearly enormous resistance to concluding that the priests involved in the scandals were untrustworthy, even where their great interest in spending excessive time with children was noticed.<sup>113</sup> Moreover, the more important trustworthy behavior in a given context is to the truster, the greater the weight that the specific trustworthiness information likely is given in forming the truster's assessment of residual trust. If it is more important for Sue to be able to trust others with her children than with her money, for example, distrust of Sam regarding the children might have more influence on her residual trust of Sam than will her inability to trust Sam with her pocketbook. On the other hand, if trusting Sam with her pocketbook is ultimately more important because it means that she must always stand on guard against his theft, then distrust with respect to her pocketbook will influence her residual trust in Sam more heavily than will her sense about whether he can be trusted with her children. Furthermore, the more salient information pertaining to specific trustworthiness is, the more it may inform an assessment of residual trust or distrust. Emotions, too, may play a role; when a situation is emotionally charged, specific trust processing can be impeded, leaving intact a pre-existing residual trust assessment.<sup>114</sup>

In sum, in contrast to the paradigmatic trust relationships described in Parts II and III.A, initially small, calculated specific trust steps are not possible in all contexts, and trust development is not always either gradual or smoothly continuous. In some relationships, particularly those of family and significant one-sided dependency, residual trust typically starts very high. Trust assessments in these relationships may be resistant to disconfirming evidence that presents itself during the course of the relationship. Moreover, outside of these automatic high residual trust relationships, initial residual trust levels can vary depending upon whether the parties view themselves as belonging to the same group. Initial residual trust levels also can vary depending on a party's reputation. Initial

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113. See generally Avedis H. Seferian & James T. Wakley, *Secrecy Clauses in Sexual Molestation Settlements: Should Courts Agree to Seal Documents in Cases Involving the Catholic Church?*, 16 GEO. J. LEGAL ETHICS 801, 812–13 (2002–03).

114. See *infra* text accompanying notes 119–21 for an explanation for why strong emotions can trigger the utilization of residual rather than specific trust or distrust.

residual trust levels may be high for community or religious leaders, or for people whose jobs or particular deeds are considered heroic.<sup>115</sup>

Our hypotheses about the relationship between the two types of trust—that specific trust informs residual trust, that residual trust in turn forms the basis of initial specific trust but that specific trust only imperfectly informs residual trust—come from an intuitive, common-sense interpretation of trust assessments that we observe in every day life. For example, people often seem to be able to make accurate assessments about the trustworthiness of another with regard to specific behavior and yet their emotional loyalties prevent them from converting that information into a judgment that the other is untrustworthy. At other times, people seem to ignore specific trust information that indicates they should not trust the other person. If specific and general, or residual, trust attitudes result from different cognitive processes, then it is possible for the truster to hold simultaneous, inconsistent beliefs about the trustworthiness of the other, and the trust decision will turn on which reasoning process dominates the decision-making. If residual trust is only imperfectly updated, or, if residual trust can dominate specific trust reasoning, causing the conscious trust assessment to be bypassed altogether, then nonoptimal trust may result.

The processing pathway (general/residual or specific/calculative) chosen to form a trust assessment can be influenced by the mood, emotion, temperament, or attitude of the evaluator when she forms her assessment. A growing number of psychologists have begun to question the idea that emotions are qualitatively distinct from cognition.<sup>116</sup> Instead, the emotions can work to aid cognition and motivate individuals to respond effectively to the world around them. A subset of these psychologists have been building a strong empirical case to support the “affect as information” hypothesis, which is based on the principle that an important kind of information used for judgment and decision making is the information gained from our own feelings.<sup>117</sup> Our feelings act as affective cues that can help guide our decisionmaking and our actions. At their most basic level, “positive affective cues serve as an incentive, reward or ‘go’ signal for

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115. See Delgado et al., *supra* note 44.

116. ANTONIO R. DAMASIO, *DESCARTES' ERROR: EMOTION, REASON AND THE HUMAN BRAIN* (1994); Timothy Ketelaar & Gerald L. Clore, *Emotion and Reason: The Proximate Effects and Ultimate Functions of Emotions*, in *COGNITIVE SCIENCE PERSPECTIVES ON PERSONALITY AND EMOTION* 355, 360 (Gerald Matthews ed., 1997).

117. Gerald L. Clore et al., *Affective Feelings as Feedback: Some Cognitive Consequences*, in *THEORIES OF MOOD AND COGNITION: A USER'S HANDBOOK* 27 (Leonard L. Martin & Gerald L. Clore eds., 2000).



using currently accessible inclinations, whereas negative affective cues serve as an inhibition, punishment, or ‘stop’ signal.”<sup>118</sup>

More subtly, positive affective cues cause us to think about our choices in very different ways than do negative affective cues. When a person experiences positive affect, she tends to rely on accessible pre-existing knowledge, beliefs, and expectations. When instead a person experiences negative affect, she tends to pay more attention to new information.<sup>119</sup> Moreover, positive affect causes people to rely more on heuristic processing, stereotypes, scripts, and schema than does negative affect<sup>120</sup> and to adopt a global rather than local focus. By contrast, negative affect leads to more systematic processing with a focus on local and specific facts.<sup>121</sup>

Specific and residual trust (and distrust) can be viewed as two types of cognitive assessments that parallel the processes triggered by emotions, moods, attitudes, and temperaments. One of the functions of residual trust in relationships is to enable a decision maker to rely on some people—typically, a relatively small number—without having to agonize over whether these people are inclined to act in the decision maker’s interest. Conversely, one of the functions of residual distrust seems to be to cause a decision maker to avoid and protect against the object of that distrust. These trust reactions can be better understood if thought about in the context of the “affect-as-information” hypothesis. In the case of residual trust and distrust then, the evaluator experiences a general positive (for residual trust) or negative (for residual distrust) feeling about the other which causes her to feel confident in her judgment about the intentions, beliefs, and/or likely behavior of the other.

Specific trust processing, in contrast, seems to be a product of bottom-up, or “low road” cognitive processes. Negative emotions like sadness and other indicia of nonconfidence are motivating the evaluator to collect more information before acting on her beliefs. When these feelings are experienced in the trust context, the evaluator is much more likely to process relevant information about the circumstances (“trust that” factors) and the other’s trustworthiness (“trust in” factors) in those circumstances before making a decision about whether trust is warranted. In these cases,

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118. *Id.* at 43.

119. *Id.* at 44.

120. Gerald C. Clore, *Why Emotions Are Felt*, in *THE NATURE OF EMOTION: FUNDAMENTAL QUESTIONS* 103, 109–10 (Paul Eckman & Richard J. Davidson eds., 1994) [hereinafter *Why Emotions*].

121. Clore et al., *Affective Feelings*, *supra* note 117, at 45, 47.

the evaluator is also better able to evaluate objectively any efforts by the other to persuade the evaluator of his trustworthiness. Moreover, an evaluator who has a great deal of experience with the behavior of the other in a given context might be more immune to the heuristic-type processing that typically can be triggered by the emotions that accompany residual trust and distrust.

Viewing trust and distrust through the lens of the affect-as-information hypothesis enables us to at least begin to understand overtrust and undertrust as emotional phenomena. To our knowledge, no psychologist has seriously studied trust through the lens of affect-as-information, so we are forced to be somewhat speculative and tentative in our conclusions, which are no doubt contingent on the results of future studies. Nevertheless, the possible insights to be gleaned from drawing this connection are well worth exploring, if only preliminarily. Our current view of that connection is as follows: overtrust and undertrust are likely to result when an evaluator—by reason of emotion, mood, attitude, or temperament—processes trust information through top-down processing mechanisms that cause her to ignore specific trust information and to rely exclusively on the residual trust or distrust belief about the other. The dominance of residual trust is common in some contexts, including those that trigger in-group/out-group stereotypes, and those that involve relationships of dependency. We explore one such relationship more fully in Part IV.

#### *D. Summary*

We attempt to build a trust framework that incorporates the findings of social dilemma games but simultaneously extends beyond the findings of laboratory experiments among strangers to better understand trust as a cognitive phenomenon. Unlike the simplistic notion of trust advanced by previous legal scholars, recent trust literature indicates that trust is not an all-or-nothing concept, nor is the concept unidimensional. Instead, people can, and often do, hold simultaneous trusting and distrusting views of one another. Given that trust and distrust coexist in relationships, we must rethink the assumption of some legal scholars that distrust-promoting measures necessarily work to paralyze relationships.

Paradigmatic trust relationships build gradually. A person develops a sense of the trustworthiness of another across specific contexts, and these specific trust assessments appear to cumulate over time to inform a sense of residual trust that guides the general relationship. To the extent that relationships are formed and maintained in a manner consistent with this

paradigmatic relationship, the role for law in promoting an optimal level of trust is presumably minimal.

However, some relationships do not follow this paradigmatic form. Family and romantic relationships, for instance, typically start with very high initial trust. Trust in these relationships presumably contributes to survival and procreation in ways that make the consequent risks of high trust warranted on balance. Not only is initial trust quite high in these relationships, but because the trust takes a residual form, and might serve important evolutionary functions, it is quite sticky, and less likely to be correctly updated by disconfirming trust-relevant information. To the extent that people in these relationships cannot be counted on to process accurately trust-relevant information, we can conclude that they are prone to overtrust one another. On average these trust levels may be optimal, but some individuals will be harmed physically, psychically, and financially by placing this trust in the loved one. In Part IV, we will argue that corporate directors and medical patients also are prone to overtrust their corporate officers and doctors, respectively. In the case of corporate directors, we propose methods by which policymakers can promote optimal trust levels. In the case of medical patients, we instead advocate methods by which the law can and does attempt to mitigate the costs of overtrust to patients.

In contrast, some relationships can be characterized as chronic undertrust relationships. When the context of the interaction or the characteristics of the other person trigger that person to be characterized as a member of an out-group, then the trust assessor will likely place too little trust in the other person. Undertrust can be paralyzing and can create hostile, antagonistic behaviors between the individuals and the groups to which they belong. Affirmative action and other integrative measures are designed at least in part to break down the socially problematic forms of distrust associated with racial, ethnic, religious, and class out-group biases.

The emotional component of trust amplifies the potential for systematic overtrust and undertrust. Positive emotions and moods cause a person to ignore specific information and to continue with the course of action she has chosen; anger, too, has this effect. In contrast, negative emotions associated with sadness and uncertainty tend to bias thought processes toward more analytical, fact-based, bottom-up, discriminating thinking. These negative emotions promote accuracy, whereas the positive emotions and anger promote action at the cost of reduced accuracy. Thus, the relationships characterized by systematic overtrust and undertrust are those that tend to generate action-promoting but inaccurate emotions. The law cannot rely on people in these relationships to gravitate toward optimal

trust levels on their own. In the next Part, we explore possible legal responses to nonoptimal trust.

#### IV. LEGAL RESPONSES TO NONOPTIMAL TRUST

As we have discussed, trust can be nonoptimal for several different reasons. Very often, what is nonoptimal is also inaccurate: a party may have inaccurately high levels of residual trust or distrust in another. Perhaps the inaccuracy is due to in-group favoritism or out-group bias. Or it may be due to difficulty in processing trust-specific information in the type of context at issue. Sometimes the solution is for parties to be encouraged to acquire more trust-specific information; other times, the solution is for parties to be discouraged from doing so. This Part discusses the mechanisms, formal and informal, that the law has available to promote optimal trust.

To promote trust, society can encourage the development of norms of cooperation, reciprocity, loyalty, and sometimes conformity. Public school as well as social and religious education all focus on the development of trustworthiness, loyalty, and cooperation as important character traits. To the extent that the norms are fostered in the community, the community members can shun or otherwise privately sanction those individuals who do not act in a trustworthy fashion. Social and internal norms therefore help reduce vulnerability by reducing the perceived magnitude of the risk of untrustworthiness of others in the group.<sup>122</sup>

Do formal legal institutions also contribute to trust? Scholars have differing views on this subject.<sup>123</sup> Those suspicious of state authority argue that the imposition of legal regulation substitutes for the facets of interpersonal relationships, including trust, which enable community to thrive.<sup>124</sup> Picking up on this theme, Larry Ribstein has recently argued that the law can do nothing to foster trust.<sup>125</sup> In fact, he argues, legal rules and regulations designed to protect one party from potential losses can be used opportunistically against the regulated party.<sup>126</sup> For example, if a buyer

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122. See Knight, *supra* note 3, 359 (“Social norms instantiate commonly held beliefs about the behavior of others. . . . When the content of the norms dictates cooperative behavior, social actors can use this information to develop expectations about the likelihood that others will cooperate, and then make a decision to act accordingly.”).

123. Compare Ribstein, *infra* note 125, with Blair & Stout, *supra* note 12.

124. MICHAEL TAYLOR, COMMUNITY, ANARCHY AND LIBERTY 57 (1982); MAX WEBER, ECONOMY AND SOCIETY (1978).

125. Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 576 (2001) (“[L]aw has nothing to do with trust.”).

126. *Id.* at 576–80.

can sue a seller for fraud, he is protected from the seller's misrepresentations, but he is also given a tool (a fraud suit) to extract more from an innocent seller than he deserves. In these cases, law can actually work to undermine trust (here, the seller's trust in the buyer).<sup>127</sup> More generally, however, Ribstein seems concerned that regulation has the effect of decreasing "the sense of vulnerability that is critical to personal trust."<sup>128</sup>

Although it is true that laws intended to encourage trust by one party can cause the other party to experience distrust, we, like many other scholars,<sup>129</sup> believe that it remains possible to foster trust through law. By definition, trust entails a willingness by the truster to make herself vulnerable to the possibility that another will act to her detriment.<sup>130</sup> The willingness to take this risk presumably turns on both the magnitude of the perceived risk and the degree of harm that the truster will suffer if it turns out that the trust was misplaced. It thus seems a logical mistake to assume that one gets greater trust by making the truster more rather than less vulnerable.<sup>131</sup> More likely, an individual has a maximum level of vulnerability that she is willing to accept, and she is unwilling to make herself more vulnerable than that. To the extent that the law can decrease her exposure to harm from trusting below her maximum vulnerability level, she is more likely to trust. By insisting that one encourages trust by increasing vulnerability, Ribstein's argument would lead us to the conclusion that *all* mechanisms for protection against predation, whether formal or informal, are trust-eroding. This must be wrong.

Instead, people seem more willing to accept vulnerability when the magnitude of the risks and costs of predation are minimized. Legal rules that call for behavior thought to be trustworthy can have both of these effects. Regarding the magnitude of risk, laws can both influence the likelihood that people will behave in a trustworthy fashion and signal to

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127. *Id.* at 576–77. Larry Garvin also points out that laws designed to achieve perfect trust can include sanctions that are so large that they cause overdeterrence and strategic behaviors. Larry T. Garvin, *Credit, Information, and Trust in the Law of Sales: The Credit Seller's Right of Reclamation*, 44 U.C.L.A. L. REV. 247, 344 (1996). Eric Posner also suggests that enforcement of many indefinite promises, such as requirements and output contracts, firm offers, and modifications can have the effect of interfering with interpersonal trust. Eric A. Posner, *Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises*, 1997 WIS. L. REV. 567, 605 (1997).

128. Ribstein, *supra* note 125, at 580–81.

129. Blair & Stout, *supra* note 12; Cross, *supra* note 14.

130. *See supra* note 19 and accompanying text.

131. The doctor-patient relationship, discussed in Part IV.C.1, turns out to be a possible exception to this general principle. In that situation, however, the source of the vulnerability is external to the parties, and the doctor's care is sought to reduce that vulnerability.

citizens that the community has adopted trustworthy norms of behavior. Both the expressive and the behavior-influencing effects of the law cause the trust evaluator to perceive a smaller risk of predation than would exist without the law. As to the costs of predation, to the extent a violation of the law yields partial compensation to the truster, she perceives a lower magnitude of harm from erroneously trusting.<sup>132</sup>

Of course, this argument has its limits. Perfect compensation and very high safety nets can have the effect of reducing vigilance on the part of the trust assessors, which in turn can decrease the payoff to developing and maintaining a trustworthy reputation. “Trust in” trust becomes irrelevant to people’s decisions to interact as it gets swamped by very high levels of “trust that” trust. However, this high “trust that” trust would prove extremely (perhaps prohibitively) costly. Society could achieve appreciable levels of trust and trustworthy behavior much more cheaply by allocating to its members some duty to acquire trust-relevant information and to invest in reputations for trustworthiness. The optimal regime is likely one akin to a “co-pay” arrangement, whereby people are largely protected from opportunism but bear some modest portion of the costs themselves. With significant but incomplete protection against opportunism, parties will retain a willingness to engage in smaller transactions. “Trust that” trust substitutes, at least temporarily, for “trust in” trust while the truster gathers information in his or her dealings about whether “trust in” trust is appropriate. As this information is gathered, the truster becomes better able to determine the areas where specific trust is warranted, as well as the areas in which specific distrust is warranted. If the truster determines from this interaction that it is appropriate to “trust in” the other significantly, then larger cooperative steps can follow. From this perspective, legal rules and regulations can be trust-enhancing.<sup>133</sup>

In the foregoing discussion, in general, the trust sought to be enhanced is specific trust. Parties are encouraged to obtain more information about one another to make more accurate assessments of each other’s level and

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132. In fact, highly redistributive taxes could similarly affect trust. Economists studying high- and low-trust countries find that, in general, the greater the amount of wealth redistribution in the society, the more individuals were willing to trust one another. Stephen Knack & Philip Keefer, *Does Social Capital Have an Economic Payoff?: A Cross-Country Investigation*, 112 Q.J. ECON. 1251 (1996); Stephen Knack & Paul J. Zak, *Trust and Growth* (Sept. 10, 1998) (working paper, on file with Claremont University). One can explain this correlation by hypothesizing that it is easier to take a risk when the safety net is more rather than less protective.

133. This concept is discussed briefly in Erin Ann O’Hara, *Choice of Law For Internet Transactions: The Uneasy Case for Online Consumer Protection*, 153 U. PA. L. REV. 1883, 1889–95 (2005).

type of specific trust. As we have discussed, one important context is that of encouraging people to deal with people outside their in-groups.

Law can also be used to encourage or enhance residual trust and distrust. Society benefits when people enter into fiduciary-type relationships in which they entrust important matters—their health, perhaps their finances—to others. In such cases, we may want to encourage residual trust—to encourage a person to simply make the binary decision to trust another person or not, and not to make further inquiries, except perhaps in response to egregious signs that the trust has been misplaced. Indeed, the process of obtaining more trust-relevant information may weaken the residual trust necessary for the relationship to work in a socially desirable manner. After all, careful trust calculations often predispose one to consider the possibility of distrust. Furthermore, encouraging the acquisition of more trust-relevant information can make the trust target feel distrusted. A party who feels distrusted may reason that if she is getting the burden of the other party's suspicion, she might as well get the benefit by behaving opportunistically.<sup>134</sup>

Conversely, society benefits when parties to a conspiracy have high levels of residual distrust of one another. The law can foster residual distrust, thereby discouraging people from interacting with each other, by providing incentives for conspirators to inform on one another and by otherwise increasing the magnitude of the risk or the cost of untrustworthy behavior.

In sum, where the law seeks to encourage trust, it does so by reducing the risk to parties of trusting one another sufficiently that they are willing to expose themselves to some level of vulnerability. We argue that the law sometimes focuses primarily on increasing specific trust; at other times, it strives to increase or at least to maintain residual trust. Where the law attempts to encourage residual trust, various mechanisms permit the truster's inquiry to stop at the choice of whether and with whom to enter a relationship. But in the many cases where more careful assessments are desirable, as parties interact more, they acquire more trust-relevant information, determining for themselves optimal levels of specific trust and distrust. To encourage the careful processing of trust-relevant information, the assessor should be subject to a co-payment in the event that she is victimized. Part III.A briefly describes some of the many ways that legal tools can work to promote specific trust, and Part III.B then

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134. See Guerra, *supra* note 25 (experiment finding that attempts to verify the behavior of honest traders causes those traders to behave poorly toward verifier).

discusses a few ways that legal tools can promote or maintain residual trust.

*A. Legal Tools for Promoting Specific Trust and Distrust*

Law can promote trust by helping to minimize the likelihood of untrustworthy behavior. Trust-promoting rules are far too numerous to adequately address here, but common examples are laws prohibiting fraud, conspiracy, theft, and unconscionable business practices.

What is the mechanism by which these and other laws promote trust? There is, of course, the obvious: laws increase “trust that” trust, if only because people think others are less likely to take actions the law forbids. But another important mechanism is that in many cases laws give enough protection to make people willing to make themselves vulnerable to others but not so much as to provide a risk-free guarantee. Consider contract law. Contracting parties must perform their obligations in good faith and according to standards of fair dealing.<sup>135</sup> There are rules not only against breach but also against opportunism in the course of contract negotiation or performance. Indeed, contract law protects the parties against opportunism made possible by legal doctrines themselves. For example, the perfect tender rule enables a buyer to refuse delivery of goods if the seller does not perfectly perform her obligations under the contract.<sup>136</sup> Unfortunately, a party receiving imperfectly tendered goods could opportunistically use law to force the tendering party to accept less than the contract price.<sup>137</sup> To deter such opportunism, the tendering party is given limited rights to cure imperfections in the Uniform Commercial Code.<sup>138</sup> Similarly, a party to a contract she no longer wished to honor might claim a right to walk away from the contract based on “information” that the other party might breach. To prevent such excuses, the law provides that the party wishing to disavow the contract must request

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135. *See, e.g.*, *Power Travel Int'l Inc. v. Am. Airlines, Inc.*, 257 F. Supp. 2d 701, 705 (S.D.N.Y. 2003); *Wilson v. Amerada Hess Corp.*, 773 A.2d 1121, 1129 (N.J. 2001); *Levine v. Selective Ins. Co. of Am.*, 462 S.E.2d 81, 84 (Va. 1995). In some cases, contract rules induce information disclosure by a party better able to assess the value of the transaction. For example, home sellers often have a duty to disclose known hidden or latent defects. *See Posner v. Davis*, 395 N.E.2d 133 (Ill. 1979); *Lawson v. Citizens & Southern Nat'l Bank of S.C.*, 193 S.E.2d 124 (S.C. 1972); *Cushman v. Kirby*, 536 A.2d 550 (Vt. 1987); *Obde v. Schlemeyer*, 353 P.2d 672 (Wash. 1960).

136. U.C.C. § 2-601 (2004). The perfect tender rule itself helps guard against opportunism of sellers who strategically cut corners rather than attempting costlier “perfection.”

137. Karl N. Llewellyn, *On Warranty of Quality, and Society: II*, 37 COLUM. L. REV. 341, 378, 389 (1937).

138. U.C.C. § 2-508 (2004).



assurances from the other party rather than simply abandoning the contract.<sup>139</sup>

Notice that contract law allows parties to limit their vulnerability to one another, but not eliminate it completely. While damages available for contract breaches nominally purport to fully compensate the nonbreaching party,<sup>140</sup> in reality there is an appreciable gap. Transaction costs, in the form of often-sizeable attorney fees, cannot be recovered, nor can emotional damages<sup>141</sup> or damages that are speculative or unprovable.<sup>142</sup> In addition, consequential damages are sometimes unrecoverable,<sup>143</sup> and the common law right of reclamation to an unsecured creditor has been significantly restricted.<sup>144</sup> Moreover, parties have difficulty getting around these damages limitations given that specific performance is limited<sup>145</sup> and liquidated damages provisions are heavily scrutinized.<sup>146</sup> Thus, parties are hardly indifferent as between the contracted-for performance and the expected value of the legal remedy for breach. Importantly, to promote optimal trust, contract remedies should not fully protect parties against breach. The gap between the two represents the vulnerable party's co-payment; ideally, the co-pay would be structured to encourage the parties to make optimal investments in trust-relevant inquiries and reputations for trustworthiness.

Two other related examples are of interest. One is the federal securities law's emphasis on disclosure rather than merit regulation. Legal safeguards ensure the accuracy of the prospectus describing an investment, but the investor is charged with making the determination of whether the investment is a good one. The government protects the investor against the possibility that the company offering its securities is lying, but the investor must garner the necessary information about the quality of the company.<sup>147</sup> Another example is government-subsidized political risk insurance for investments in companies in emerging markets countries. The government

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139. RESTATEMENT (SECOND) OF CONTRACTS § 251 (1978).

140. E. ALLAN FARNSWORTH, CONTRACTS § 12.1 (2d ed. 1998) (nonbreaching party entitled to benefit of bargain).

141. *Id.* § 12.17.

142. *Id.* § 12.8.

143. *Id.* § 12.14.

144. Larry Garvin suggests that the reclamation right, because it is rooted in concepts of fraud, was intended to provide protection to creditors in order to enhance trust in commercial relationships. Garvin, *supra* note 127.

145. FARNSWORTH, *supra* note 140, § 12.8.

146. *Id.* § 12.18.

147. See generally LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 169–223 (3d ed. 1989).

limits exposure to political risk, which is hard for the investor to appraise.<sup>148</sup> However, the more traditional risks of the investment remain with the investor. In both of these cases, legal tools are implemented to remove some but not all specific trust concerns. Where the assessor can protect herself by gathering and processing trust-relevant information, her co-payment remains relatively high.

Political risk insurance is an example of the use of an imperfect safety net to motivate parties to expand their dealings to strangers. As we have argued, parties might rationally deal only with known parties, preferring to save themselves the costs and uncertainties of dealing with unknown parties. Society benefits if people broaden the range of parties with whom they are willing to deal; parties previously excluded benefit as well. Greater numbers of potential contracting parties create more competition, which produces social benefits as well as benefits to the individuals willing to transact with strangers. In general, legal measures intended to encourage contracting with strangers work, if at all, by (1) encouraging interactions that enable parties to gather information relevant to making specific trust assessments about one another; and (2) altering the parties' assessments of the degree to which they can "trust that" others will act in the desired fashion.

Other mechanisms exist by which the law encourages parties to acquire specific trust and distrust. Contracting parties are given considerable latitude to craft their contracts. Parties are therefore encouraged to investigate, specify, and control the level of risk each will undertake in a contract. Loan covenants, for example, enable creditors to control the ability of the debtor to act in ways that jeopardize the repayment of the debt.<sup>149</sup> And sometimes a contracting party wishes to use a contractual provision in order to *decrease* the trust the other party places in the performance of the contract. Consider security alarm contracts, where alarm companies routinely limit their liability for homeowner loss to a very small sum.<sup>150</sup> Although some might view these contractual provisions

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148. See generally Overseas Private Investment Corp., <http://www.opic.gov/Insurance/home.htm> (last visited June 23, 2005).

149. For a fascinating treatment of formal and informal creditor protection mechanisms used against firms in financial distress, see Douglas G. Baird & Robert K. Rasmussen, When Good Managers Go Bad: Controlling the Agents of Enterprise (Feb. 2005) (unpublished manuscript, on file with authors).

150. See, e.g., *Lobianco v. Prop. Prot., Inc.*, 437 A.2d 417, 419 (Pa. Super. Ct. 1981).

as unconscionable,<sup>151</sup> perhaps instead they are merely attempts by the alarm companies to signal to customers that they should not place too much faith in the company to ensure home security. Instead, some personal vigilance against theft by the homeowner (e.g., locking the door and stopping mail delivery when away) coupled with security efforts on the part of the firm might provide a more optimal mix for enhancing security.<sup>152</sup>

Law also can help produce trust-relevant information. Auditing and monitoring by government and private entities can help to produce trust-relevant information for others to rely on. But promoting trust may sometimes require limiting access to information. For instance, the privacy of parties transacting online is protected with monitoring and enforcement of company privacy policies and through the imposition of rules about the use of information.<sup>153</sup>

Sometimes the law suboptimally discourages the production and acquisition of trust-relevant information. A notorious example is the availability of federally funded insurance on savings and loan associations (“S&Ls”), coupled with the loosening of restrictions on the S&Ls’ investing practices. The result, as is now well known, was that depositors did not bother to inquire as to the risk of their S&L’s investments and the S&Ls sometimes failed, leaving the federal government to bail them out to avoid a default to the depositors.<sup>154</sup>

### *B. Legal Tools for Promoting or Maintaining Residual Trust and Distrust*

Occasionally, legal measures affect trust not by encouraging or changing the results of carefully calibrated trust assessments but rather by working to trigger the primacy of the influence of an individual’s residual trust or distrust in another. Law enforcement strategies and criminal conspiracy laws work together to trigger distrust in criminal associates.<sup>155</sup> Undercover police attempt to infiltrate the criminal world, police interrogators suggest that associates have betrayed or will betray the

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151. See *Hanover Ins. Co. v. D & W Cent. Station Alarm Co.*, 560 N.Y.S.2d 293, 295 (N.Y. App. Div. 1990) (stating that exculpatory clauses in security alarm contracts are wholly void to the extent they grant exemption from liability for gross negligence).

152. We thank Bob Rasmussen for making this observation. Of course, this explanation justifies limitations on the company’s contractual but not tort liability. See Baird & Rasmussen, *supra* note 149.

153. See Ian Goldberg et al., *Trust, Ethics, and Privacy*, 81 B.U. L. REV. 407 (2001).

154. There is extensive literature on the subject. See, e.g., Fed. Deposit Ins. Corp., <http://www.fdic.gov/bank/historical/s&l/slbib1.html> (last visited Feb. 28, 2005).

155. See Katyal, *supra* note 13.

suspect, criminals who rat out others can escape prosecution, and crimes committed with others are often more severely punished than the same crimes committed alone. The trust lens provides an alternative explanation for these legal mechanisms to that provided by traditional law and economics scholars. Law and economics scholars correctly assert that collective crimes are often harder to detect and prosecute while at the same time are capable of causing more harm.<sup>156</sup> To them, these police practices and legal measures work together to increase the criminals' expected punishment and thereby discourage criminal activity.<sup>157</sup> It may be that, as the economists suppose, one contemplating a crime will carefully calculate the costs and benefits of legal punishment. But we think that the possibility of betrayal and harsh punishment may instead evoke fear, a negative emotion that inhibits careful calculation and instead encourages heuristic processes designed to cause the person to avoid coming anywhere near the source of the feared harm.<sup>158</sup>

In other situations, legal mechanisms are designed to encourage—or at least not discourage—individuals' reliance on residual trust. A paradigmatic case involves fiduciaries. Fiduciary relationships are defined in part as those relationships marked by high trust.<sup>159</sup> Although the concept of a fiduciary is broad<sup>160</sup> and fiduciary duties apparently vary with the particular relationship,<sup>161</sup> in many fiduciary relationships, one party is dependent upon another party, who typically has specialized training and/or superior access to information relevant to the dependent party's vulnerable situation.<sup>162</sup> In the doctor-patient, the attorney-client, and the clergy-parishioner contexts, legal obligations are supplemented by a strong

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156. Richard Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1218–19 (1985).

157. Katyal, *supra* note 13, at 1363–64.

158. See Clore, *supra* note 120, at 110–11.

159. See, e.g., *Andersons, Inc. v. Consol, Inc.*, 348 F.3d 496, 509 (6th Cir. 2003) (characterizing a fiduciary relationship as one in which one party places special confidence and trust in another).

160. See generally Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983).

161. Sometimes courts vary in their willingness to impose fiduciary obligations on one of the parties in a particular type of relationship. Courts currently disagree, for example, over whether broker-dealers owe fiduciary duties to their clients. Interestingly, the courts' view of the issue seems to turn on the sophistication of the clients and the degree of control the broker-dealer had over the accounts. See Peter H. Huang, *Trust, Guilt, and Securities Regulation* 151 U. PA. L. REV. 1059 (2003). Where clients are more sophisticated and less dependent, they are more inclined to make reliable calculations of trust assessments. Conversely, less sophisticated consumers are at risk of falling prey to heuristic distrust assessments without special fiduciary protections.

162. We do not claim that our analysis applies to all fiduciaries. Where the parties are symmetrically situated, the analysis is more difficult. For instance, general partners are each others' fiduciaries, yet becoming a partner in a general partnership is typically an exceedingly long process whereby a great deal of trust-relevant information is ferreted out.

code of ethics designed to encourage trustworthy behavior on the part of the fiduciary. Many of the rules applied to these fiduciaries are expressed in absolute terms and cannot be circumvented in a contract.<sup>163</sup> Consider, for instance, the “sole interest” rule, which requires a trustee to administer a trust solely in the interest of the beneficiary and renders voidable transactions by the trustee for the trustee’s personal account without any further inquiry as to whether the trust might have benefited therefrom.<sup>164</sup> One plausible explanation for these onerous and absolutely-stated rules for fiduciary conduct is the rules’ effort to put to rest any doubts on the part of the dependent party, whose trust is often essential to the effectiveness of the fiduciary relationship.<sup>165</sup> And the rules are not just onerous and absolutely stated: in many areas of the law, the applicable fiduciary rules constitute a standardized, law-created package.<sup>166</sup> There is less for a principal to inquire about. The selection of a fiduciary is therefore made easier—fewer (potentially trust-eroding) inquiries need be made.<sup>167</sup>

There are many other contexts in which policy makers wish to encourage residual trust. The law surrounding contracts between insurance companies and consumers (or small business people) provides an example. Consider the doctrine of reasonable expectations as applied to interpret insurance contracts.<sup>168</sup> The doctrine honors the expectations the court

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163. See, e.g., *Levisohn, Lerner, Berger & Langsam v. Med. Taping Sys., Inc.*, 20 F. Supp. 2d 645, 650 (S.D.N.Y. 1998) (holding nonrefundable retainer fee agreements void because they “compromise the client’s absolute right to terminate the unique fiduciary attorney-client relationship” (quoting *In re Cooperman*, 633 N.E.2d 1069, 1071 (N.Y. 1994)); *Cain v. Bd. of Comm’rs of the Ala. State Bar*, 345 So. 2d 1343, 1346 (Ala. 1977) (attorney violated his fiduciary duty by failing to fulfill “his absolute duty to give his client a full, detailed, and accurate account of all money and property entrusted to him”).

164. See generally John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L. J. 929 (2005) (critiquing the sole interest rule).

165. Often the fiduciaries need open, honest communication from the dependent party. Moreover, in the doctor-patient context discussed *infra* in Part IV.C.1, patient trust often works to improve health outcomes.

166. See generally Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 ORE. L. REV. 1209 (1995); Frankel, *supra* note 160. Professor Frankel discusses, among other things, the detailed regulatory regime regulating investment advisers, who are fiduciaries for their clients.

167. Consider also as an analogy Merrill and Smith’s argument that because property is more importantly about third party rights than is contracting, parties have far less flexibility in how they structure their dealings in property. Parties to a property transaction have only a few forms to choose from; third parties can learn a great deal simply by learning which form was used. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L. J. 1 (2000). Fiduciary-type relationships often also come in standardized bundles; if third party enforcement is to be a larger part of the picture, there’s arguably less for the third parties to inquire about, and the enforcement process can be more mechanical as well.

168. “The doctrine of reasonable expectations as applied to insurance policies has been adopted by more than half the states.” CHARLES L. KNAPP, NATHAN M. CRYSTAL & HARRY G. PRINCE, *PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS* 376 (5th ed. 2003). For a general discussion

thinks the purchaser of insurance reasonably had as to the coverage of the policy but did not expressly articulate.<sup>169</sup> For reasons well encompassed within the traditional law and economics analysis, making it too easy for a party to get protections it did not bargain for is perilous. But if an insurance company, which knows a great deal more about insurance than do most of its customers, includes in its standard-form, typically non-negotiable contracts provisions that allow it not to cover an event that is clearly within the spirit of what the purchaser reasonably thought she was getting, the reasonable expectations doctrine may be available to elevate that spirit over the contract's literal wording. In the consumer context, some laws limit the terms that can be included in the insurance contract, and courts sometimes will strike terms from the contract that might tend to surprise the consumer.<sup>170</sup> Consumer protection measures sometimes take into account the reality that consumers will not read and comprehend complex contracts, and if they consequently fear getting burned by surprise contract provisions, they might choose not to contract at all. Where consumer protections exist,<sup>171</sup> they enable consumers to rest assured that the terms of their contracts will comply with minimum standards of reasonableness.<sup>172</sup>

Many of the examples provided so far in this Part involve efforts on the part of policymakers to promote socially optimal trust levels. That is, people are assumed to make use of available trust-relevant information, but social welfare is promoted by altering the trust-relevant decisions that people make. In a few relationships, however, the cognitive mechanisms described in Part III can be expected to work to impede the accurate processing of at least some trust-relevant information. At times, EMT suggests that this faulty processing serves the individual's interests on

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of the doctrine, see *id.* at 369–81. The doctrine may be more broadly applicable to all contracts of adhesion. *Id.* at 380; see also RESTATEMENT (SECOND) OF CONTRACTS § 211(3). German law has a roughly similar approach, putting the onus on the party presenting the other party with standardized terms to make sure the terms are noticed and understood: Section 9 of the Standard Contract Terms Act of 1976 (“Section 9”) “makes invalid any term to which specific attention has not been drawn . . . that constitutes ‘unfair surprise’ or is ‘unfairly detrimental’ to the nondrafting party.” Hill & King, *supra* note 30, at 910. See also Jeffrey W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 CONN. INS. L.J. 181, 184–89 (1998–99); Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2007).

169. KNAPP, CRYSTAL & PRINCE, *supra* note 168.

170. FARNSWORTH, *supra* note 140, § 4.29. Of course, this latter judicial doctrine is a specific example of a concern about the use of standard-form contracts.

171. See *id.* for examples.

172. It is also possible that strict liability in the tort context serves a similar trust maintenance function.

average, even though it leaves the trustor vulnerable either to predation or to the costs of lost opportunities. Sometimes the law can minimize these costs, either through the promotion of more accurate information processing or through measures that enhance trustworthiness and/or minimize the costs of opportunism. Some of the examples described so far in this Part address problems of undertrust—people disfavor strangers and out-groups in their dealings. In the next Subpart C we return to the cognitive trust biases that can cause people in certain types of relationships to ignore information that suggests distrust is appropriate.

### *C. Examples of Overtrust*

#### *1. Doctor-Patient Relations*

##### *a. Thick Trust as Overtrust*

From our perspective, thick-trust relationships, perhaps by definition, provide contexts where, in general, overtrust minimizes error costs. They are characterized by a willingness to trust even when erroneous trust could prove very costly, and they typically involve high degrees of interdependency. In fact, many trust scholars separately categorize thick-trust relationships as though they differ in kind from other trust relationships.<sup>173</sup> The quintessential thick-trust relationship is a family relationship where members' utility functions significantly overlap. In these contexts, people are prone to blindly trust one another.

One of the authors has experienced the costs of overtrust of a family member—a brother-in-law—who turned out to be a thief and a liar. This relative stole from the author, from her grandmother, her father, his grandmother, and his siblings. Most of the family members were aware that they had been victimized by someone, but it did not occur to any of them for some time that the brother-in-law was the thief. What an amazing coincidence that so many of us had been robbed that year! What was the world coming to? Was it possible that a ring of thieves had assembled private information about each of us? The truth stared us in the face, and yet none of us was able to discern it.

The costs of this overtrust turned out to be small relative to the costs associated with distrusting close family members. We all want to think that we can trust members of our family unconditionally. From the EMT

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173. See, e.g., Russell Hardin, *Gaming Trust*, in OSTROM & WALKER, *supra* note 38, at 80, 92–95 (discussing problems that arise if trust between strangers or acquaintances is equated with thick trust relationships).

perspective, it might be dangerous to leap into battle wondering whether your brother will back you up or whether your sister will raise your child if you should die. Misfeasance and imperfect agency are not unknown in one's family. But betrayal and malfeasance—these issues are off the table in thick-trust relationships.

We argued above that the contexts where we expect overtrust are contexts where trust decisions tend to be made subconsciously rather than consciously. Moreover, instead of processing specific information carefully, trust decisions come from thick residual trust, at least in the family context. In fact, people in thick-trust relationships often refuse to process specific information that indicates distrust might be in order. Negative traits can be turned into positive ones, as for example when a person's failure to complete work on time is viewed by close friends as a commitment to getting the job done right.<sup>174</sup> Moreover, individuals in thick-trust relationships are often quick to attribute the cause of harm to external factors, such as unusual stressors, rather than to the other's untrustworthy behavior.<sup>175</sup> Thus, excessive trust can perpetuate itself with a compounding disconfirming bias.<sup>176</sup>

Non-family thick-trust relationships are sometimes assumed to take a long time to form.<sup>177</sup> After all, it can take quite some time before a person is willing to blindly trust another with matters of great consequence. Interestingly, however, in some relationships, perhaps supported by EMT, otherwise levelheaded people tend to be willing to place themselves fairly quickly into positions of significant vulnerability. For example, one can fall in love and wrap herself around her new "partner" in a matter of weeks; it does not take much for a con man to place his hands on the assets of a besotted paramour. An abundant literature on the doctor-patient relationship suggests that, in that context as well, thick trust forms quickly.<sup>178</sup>

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174. Daniel J. McAllister, *The Second Face of Trust: Reflections on the Dark Side of Interpersonal Trust in Organizations*, 6 RESEARCH ON NEGOTIATIONS IN ORGS. 87, 99 (1997).

175. *Id.*

176. Robinson, *supra* note 109, at 576–77 (1996) (stating that people tend to attribute an actor's behavior to internal or external causes depending upon which is consistent with their attitudinal expectations).

177. See, e.g., Roy J. Lewicki & Carolyn Weithoff, *Trust, Trust Development, and Trust Repair* 86, 92, in THE HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE (Morton Deutsch & Peter T. Coleman eds., 2000).

178. See *infra* Part IV.C.1.a.



*b. Doctor-Patient Trust and its Health Benefits*

Patients often place great trust in their physicians as caregivers.<sup>179</sup> Very early in the doctor-patient relationship the patient might need to agree to disrobe, to enable probing examination, to undertake a course of prescription medication, to be anesthetized and cut into, and/or to place in the hands of her doctor the power to choose the course of potentially life-saving treatment. The more sick, and therefore the more vulnerable the patient is, the greater the trust that the typical patient experiences. In fact, “[t]his deeply personal type of trust is paralleled only in fraternal, family, or love relationships.”<sup>180</sup> Some scholars describe the beliefs and behaviors of the sick patient as regressive—a return to an infantile state where the physician is placed in an all-powerful, parental role.<sup>181</sup> Others note that “[e]ven short-term medical relationships can generate strong bonds and intense feelings of intimacy.”<sup>182</sup>

Very high levels of trust are also placed in physicians by patients who are not seriously ill.<sup>183</sup> Recent survey data indicate that trust in doctors has remained consistently high over time.<sup>184</sup> Ninety percent or more of people surveyed express some degree of trust in their doctors,<sup>185</sup> while two-thirds of subjects express the highest levels of trust in their doctors.<sup>186</sup> Given that not all doctors can be highly competent and selfless, and that none of them are omnipotent or omniscient, it seems safe to conclude that many patients are prone to overtrust their doctors—that is, to trust them beyond what a rational calculative assessment would warrant.<sup>187</sup>

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179. See Mark A. Hall, *Law, Medicine, and Trust*, 55 STAN L. REV. 463, 477 (2002) (“Trust is a defining aspect of strong caregiver relationships, one that gives them fundamental meaning and value.”).

180. *Id.* at 471.

181. Cf. Mark A. Hall et al., *Trust in Physicians and Medical Institutions: What Is It, Can It Be Measured, and Does It Matter?*, 79 MILBANK Q. 613, 615 (2001) (discussing the fact that some patients tend to imbue their physicians with “superhuman powers”).

182. Hall, *supra* note 179, at 477 (quoting Charles Fried on same point).

183. *Id.* at 471–72 (noting that a bad flu and relentless pain can also profoundly affect a patient’s feelings and that the examination and agreement to take a recommended medication each require high levels of trust by the patient).

184. *Id.* at 487–88 (discussing studies).

185. Thomas H. Gallagher et al., *Patients’ Attitudes Towards Cost-Control Bonuses for Managed Care Physicians*, HEALTH AFF., Mar.–Apr. 2001, at 186, 187.

186. Timothy Lake, *Do HMOs Make a Difference? Consumer Assessments of Health Care*, 36 INQUIRY 411, 414 (2000).

187. Indeed, people seem to have consistently high levels of trust in their physicians notwithstanding some evidence of a decline in systemic levels of trust in health care providers generally. Evidence for the decline in systemic levels of trust includes the following: in 1966 73 percent of Americans surveyed reported having confidence in medicine, but by 1993 the level has declined to 22 percent. Robert J. Blendon et al., *Bridging the Gap Between Expert and Public Views*

Moreover, unlike in Lewicki's paradigmatic model of trust, patients seem to be unable to compartmentalize their trust assessments of their physicians. Studies have attempted to measure the relative influence of different dimensions of patient trust. Patients look for their doctors to be competent and honest, to act in their best interests, to treat them with care and respect, to advocate on their behalf where necessary, to avoid conflicts of interest, and to keep their information confidential.<sup>188</sup> Scholars have found that subjects simply lump all of these dimensions together.<sup>189</sup> For example, a doctor who is thought to be low in honesty is presumed to be incompetent and disloyal, and a competent doctor is presumed to be loyal and likely to keep the patient's confidences. This suggests that patients have one, residual-type trust assessment of their doctors rather than a more calculative specific and nuanced assessment of the doctor's particular strengths and weaknesses.

The causes of this propensity to overtrust one's doctor are not well understood. Some have speculated that there might be an evolutionary explanation.<sup>190</sup> Others have suggested that patients have a strong psychological need to deny the severity of their health crisis by convincing themselves that their doctor can cure the problem.<sup>191</sup> Whatever the cause of our inclinations, overtrust in our caregivers appears to be enhanced by our social practices.<sup>192</sup> For instance, patients are routinely kept waiting at their doctors' offices; when they are seen, they are made to disrobe into garments that convenience the doctor at the expense of the patient's dignity.

Moreover, unlike nonthick trust, trust in physicians seems to be unaffected by the truster's general views about the trustworthiness of

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*on Health Care Reform*, 269 JAMA 2573, 2576 (1993). In 1993, more than 60 percent of respondents surveyed reported feeling that doctors were too interested in making money, and nearly 70 percent reported a belief that "people are beginning to lose faith in doctors." American Medical Ass'n, Public Opinion on Health Care Issues 21–22 (1993). These numbers reflect an increase of about 10 percent over the numbers reported about a decade earlier.

188. Hall et al., *supra* note 181, at 620–23 (discussing various dimensions of trust).

189. *Id.* at 623–27 (citing three studies).

190. Erin Ann O'Hara, *Apology and Thick Trust: What Spouse Abusers and Negligent Doctors Might Have in Common*, 79 CHI.-KENT L. REV. 1055 (2004). O'Hara's hypothesis is that our brains evolved during a period of time in which caregivers were typically family members and, in any event, in short supply. In those environments there might be a strong evolutionary advantage to trusting rather than distrusting the caregiver.

191. *See, e.g.*, Hall et al., *supra* note 181, at 617 ("[T]he extraordinary strength of trust in physicians . . . may arise as a coping mechanism in response to the intense psychic distress created by illness.").

192. O'Hara, *supra* note 190, at 1060.

others.<sup>193</sup> Empirical studies of patient trust indicate that patients with high- and low-trust personalities report trusting their doctors at similarly high levels.<sup>194</sup> Differences in tendency to trust apparently affect only the decision to seek medical care from a new physician and not the trust placed in the previously chosen doctor.

Overtrust might seem to be problematic: a rational calculative assessment might warrant less trust. Interestingly, however, overtrust in one's physician might on average generate positive benefits for the health of the patient. Patients who trust their doctors are more likely to seek care when sick, more likely to provide personal information relevant to an accurate diagnosis, more likely to agree to undergo recommended treatment, more likely to stick with a recommended health regime, and perhaps more likely to experience positive health benefits from the trust itself.<sup>195</sup> On the last point, there is growing evidence that trust in one's physician can have a powerful placebo effect on patients.<sup>196</sup> "[T]he doctor himself is a placebo or a therapeutic agent, regardless of the particular technique used or its independent, biochemical effectiveness."<sup>197</sup> In fact, patients often begin to feel better as soon as they know that they have a physician who is working to help them.<sup>198</sup> Overtrust can cause an individual patient to disregard trust-relevant information and suffer a harmful health effect as a consequence, but without it, patients as a class will likely have poorer health. Given that overtrust can be beneficial to the patient, it is not clear that legal rules should be adopted to steer patients

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193. Trust in intimate interpersonal relationships has been described as follows:

Intimate interpersonal relationships have both a history and a future. They are not static laboratory still frames nor can they be explained purely in terms of each individual's personal characteristics, dynamics, or style. If John is involved in a relationship with Marsha, whether he trusts her to keep a secret is apt to be based on beliefs about her personality, her past history of betrayal of confidences, and the current climate of their association. John's general trust in people and whether he is willing to trust his Congressman or insurance agent . . . may be only marginally relevant.

Cynthia Johnson-George & Walter C. Swap, *Measurement of Specific Interpersonal Trust: Construction and Validation of a Scale to Assess Trust in a Specific Other*, 43 J. PERSONALITY & SOC. PSYCHOL. 1306, 1307 (1982). This swamping of an individual's generalized trust attitudes by the emotions related to and history of involvement with the specific trust target also occurs in the physician-patient relationship.

194. Hall et al., *supra* note 181, at 627 ("Speculation that people's basic outlook on life or worldview affects their ability to trust physicians is not borne out by existing studies, which have not found a strong or consistent relationship with general measures of social trust or cynicism.")

195. *Id.* at 629; David H. Thom et al., *Further Validation and Reliability Testing of the Trust in Physician Scale*, 37 MEDICAL CARE 510 (1999); Hall, *supra* note 179, at 478-82.

196. Hall, *supra* note 179, at 479-80.

197. *Id.*

198. *Id.*

away from this overtrust.<sup>199</sup> An individual suffering a bad health outcome on account of an incompetent doctor certainly would be better off not having trusted that doctor. But it does not follow that individuals would be better off being wary of doctors generally.

Indeed, whether or not patient trust is nonoptimal from a social perspective is difficult to assess. The social benefits to patient overtrust include the fact that by improving medical outcomes, patient trust reduces the social costs of providing health care. The social costs of overtrust include the fact that patients are likely very poor monitors of their doctors' caregiving. If patients do not monitor their physicians, then doctors might learn that they can benefit by behaving in an untrustworthy fashion—by providing inferior care to their patients. Instead of addressing this problem by diminishing patient trust, however, we have as a society wisely chosen to address the problem by regulating doctors and using medical ethics rules to attempt to inculcate strong patient-protective norms. At the foundation of the ethics rules is the Hippocratic Oath, commanding a physician to do no harm.<sup>200</sup> Each of these tools reflects an effort to address the problem with increased trustworthiness by physicians rather than through decreased patient trust.

In any event, efforts to erode patient trust to a more accurate level would likely prove unsuccessful. Because patients resist calculative methods for evaluating physician trustworthiness,<sup>201</sup> it may be difficult to use legal tools to influence trust in marginal ways. Indirect mechanisms to influence trust in the relationship are far more likely to be ignored in favor of feelings about the relationship itself. Thus, as regards an existing high-trust patient-physician relationship, only legal tools strongly and directly targeted at the relationship are likely to work, and those tools are likely to erode patient trust further than policymakers would like.

Legal tools are most likely to influence trust assessments for relatively healthy patients who are at the point of choosing among doctors. Healthy patients are more likely to be capable of thinking about trust in a conscious, calculative fashion, and the newness of the relationship will

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199. Of course, we treat the effects of patient trust "on average." There are other circumstances where patient trust can prove harmful. For example, if a patient has high trust in a physician, an unequivocal negative prognosis could turn into a self-fulfilling prophesy. Also, a patient who places absolutely no trust in physician care might work harder to remain healthy. Given the empirical connection between trust and health outcomes, however, these possibilities must occur considerably less frequently than the beneficial effects noted in the text.

200. Jonathan R. Cohen, *The Immorality of Denial*, 79 TUL. L. REV. 903, 928 (2005).

201. Indeed, patient trust in physicians is believed by some to be remarkably resilient. Hall, *supra* note 179, at 507.

enhance the patient's capabilities. At that point, but curiously not later, patients correctly perceive that they have a choice of health care providers. Patient trust often develops very rapidly,<sup>202</sup> however, so the window of time for careful reflection is likely small. At no point is patient distrust likely to remain compartmentalized, however, so policymakers who wish to reduce patient trust with regard to one facet of the relationship must be willing to accept reduced trust across the gamut of physician trust issues.

If, as we believe, patients should have high residual levels of trust in their physicians, then regulation of physicians should not have the unintended consequence of reducing patient trust in their physicians. Where trust exists, and where patients are very sick, the concerns are negligible—it likely takes a large and direct measure to erode the patient's trust. Where relationships are forming, however, measures that directly affect the interaction between doctor and patient can influence the patient's trust in the physician. For healthy patients, an erosion of trust can cause the patient to be less likely to take initial health care steps.<sup>203</sup>

Many legal and ethical measures target physician trustworthiness rather than patient trust. However, high trust in physicians can complicate the policymakers' efforts to regulate the trustworthiness of physician behavior. To the extent that the effectiveness of legal efforts is influenced by the ability or willingness of patients to carefully evaluate trust-relevant information, high levels of patient trust will erode the benefits of the legal tool. Take, for example, medical malpractice. Most doctors believe that the legal system has gone too far with malpractice liability.<sup>204</sup> They cite the fact that a very small fraction of malpractice suits are meritorious.<sup>205</sup> Lawyers, on the other hand, often take the position that the doctors need the disciplining function that the tort system provides.<sup>206</sup> Indeed, the tort system may well do too little to discipline doctors. After all, the vast majority of patients who suffer from physician negligence never assert a claim for compensation.<sup>207</sup> Moreover, there is growing evidence that the easiest way for a doctor to avoid a malpractice suit after making a mistake is to apologize to the patient and pledge to try to fix the problem or

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202. *Id.* at 477 (“[E]ven short-term medical relationships can generate strong bonds and intense feelings of intimacy.”).

203. *Id.* at 478 (noting that minimal trust in the physician is necessary for patients to seek care).

204. Paul C. Weiler, *Fixing the Tail: The Place of Malpractice in Health Care Reform*, 47 RUTGERS L. REV. 1157, 1158 (1995).

205. *Id.* at 1162.

206. *Id.* at 1159.

207. *Id.* at 1164.

minimize the damage.<sup>208</sup> The mismatch between negligence and malpractice suits can be partially explained by reference to the nature of the patient's trust in the physician. When a patient places high levels of trust in the doctor, he is more inclined to interpret information consistently with that trust.<sup>209</sup> Although his health outcome is poor, he may attribute the problem to a whole host of factors other than the doctor's mistake. Even when it is clear that the doctor made a mistake, a heartfelt apology often has the effect of restoring the trust feelings in the patient by communicating to the patient that the doctor did wrong but is at heart a trustworthy and therefore "good" doctor. When health outcomes are poor and the doctor seems uncaring or the patient is unable to accept a poor outcome, then the patient is more likely to interpret the bad outcome as a breach in trust and is consequently more likely to sue.

### *c. Policy Implications*

Recently, legal scholars have been exploring and debating the trust implications of various measures related to health care. We wish to explore here just three of the measures: (1) medical malpractice standards and recoverable damages; (2) informed consent laws; and (3) physician duty to treat.

#### *(1) Medical Malpractice*

Recently, health care scholars have debated the issue of how patient trust in physicians should affect the standard by which physicians' conduct is scrutinized by juries in medical malpractice cases. Authoritative texts typically claim that doctors are not negligent if they behave according to recognized customary practices of physicians.<sup>210</sup> In other industries, however, actors are subject to a reasonable person standard,<sup>211</sup> which makes it possible for a jury to scrutinize the reasonableness of the industry customs.<sup>212</sup> Philip Peters claims that, notwithstanding the law stated in

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208. Jonathan R. Cohen, *Apology and Organizations: Exploring an Example from Medical Practice*, 27 *FORDHAM URB. L.J.* 1447, 1458–59 (2000).

209. Hall et al., *supra* note 181, at 618 (“[T]rust colors one’s perceptions of the results. Through the resolution of cognitive dissonance, patients with high trust are more likely to perceive performance positively, even if it is objectively inferior.”).

210. See, e.g., DAVID M. HARNEY, JR., *MEDICAL MALPRACTICE* 89 (1973); W. PAGE KEETON ET AL., *PROSSER AND KEETON ON TORTS* § 32 (5th ed. 1984).

211. KEETON ET AL., *supra* note 210, § 33.

212. See *Hoemke v. New York Blood Center*, 912 F.2d 550 (2d Cir. 1990); *Transportation Ins. Co., Inc. v. Hunzinger Construction Co.*, 179 Wis. 2d 281, 507 N.W.2d 136 (Wis. Ct. App. 1993).

authoritative texts, a substantial and growing minority of courts have shifted to a reasonable person standard for medical malpractice cases.<sup>213</sup> To Peters, this shift is a reflection of the fact that public trust in doctors has eroded over the past few decades.<sup>214</sup> Deference to custom is unwarranted in the current practice climate, he argues, because doctors can no longer be counted on to uncompromisingly represent the patient's interests.<sup>215</sup> In contrast, Mark Hall argues that to the extent the customary standard is still applied in malpractice cases, it is justified because patients place far too much faith in their doctors, and jurors, like patients, are inclined to expect doctors to be godlike, and are therefore more likely to impose excessive liability under a simple reasonableness standard.<sup>216</sup> The authors seem to disagree over whether doctors should be subject to more or less liability as a consequence of the fact that the justice system has been overestimating the confidence that should be placed in physician care.

We argued above that it is desirable for patients to have high residual trust in their doctors. Will the liability standard affect the degree of trust that patients have in their physicians? Probably not.<sup>217</sup> Patient trust in a particular physician seems to turn on little more than the patient's belief that the physician will act to help the patient improve her health. That judgment appears to turn on little more than the interpersonal interaction between the patient and the doctor.<sup>218</sup> The nuances of legal rules applied by courts in malpractice cases are unlikely to affect the patient's trust for two reasons. First, the patient is unlikely to know and even less likely to understand the import of the differing standards: the laws applied in malpractice cases are too unlikely to affect her well-being for her to pay attention. Second, even if she knew of the differing standards, it is not clear what, if any, effect it would have on her trust in her doctor. As a close personal relationship predicated on thick trust, her feelings about the relationship will swamp any effects of this indirect, remotely applicable law. As regards new physician-patient relationships, it is unclear what the presence of the law signals. One possibility is that a higher liability

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213. Philip G. Peters, Jr., *The Quiet Demise of Deference to Custom: Malpractice Law at the Millennium*, 57 WASH. & LEE L. REV. 163, 164 (2000).

214. *Id.* at 196–200.

215. Philip G. Peters, Jr., *The Role of the Jury in Modern Malpractice Law*, 87 IOWA L. REV. 909, 951–54 (2002).

216. Hall, *supra* note 179, at 492.

217. Hall's recent work supports this view in general. Mark A. Hall, *Can You Trust a Doctor You Can't Sue?*, 54 DEPAUL L. REV. 303 (2005).

218. Hall et al., *supra* note 181, at 628.

standard signals that doctors are untrustworthy and that the law is trying to address that untrustworthiness. But an equally plausible interpretation is that lawmakers recognize that patients want to have high trust in their doctors and the law directs doctors to follow the higher standard of care. In any event, the ability of patients to separate their own doctors from doctors as a class suggests further that the details of the legal standard are unlikely to affect patient trust. Instead the standard of care should be set without regard to trust concerns.

The same analysis can be applied to the issues of liability caps and recovery of punitive damages in medical malpractice cases. The existence of caps is unlikely to affect patient trust. Here, as in the customary standard context, Hall seems to advocate more difficult recovery standards on the grounds that jurors expect too much of doctors and will punish them for behavior that is not actually negligent.<sup>219</sup> This concern seems inapt, however, given the fact that people seem quite capable of separating their trust in their own physicians from the question of the trustworthiness of other physicians. Hall makes no argument that the patient's overtrust is somehow transferred to the jurors, and, if anything, it seems that precisely the opposite should occur. That is, when jurors hear that a patient excessively trusted her doctor, the emotionally detached juror might well wonder why she would have expected the doctor to prevent all possible adverse outcomes. In the end, our trust analysis suggests that arguments that the standard of care and the damages rules applied in malpractice suits will adversely affect patient trust in doctors are not well-founded; concerns about trust hence do not support any side in the debate.

## (2) *Informed Consent*

Informed consent is considered one of the hallmarks of the patient's right against the judgment of the physician. Tort law protects against unwanted touching, and medical treatment is a form of invasive touching.<sup>220</sup> To ensure that the touching is consensual, doctors must get the consent of patients (where possible) prior to giving medical care.<sup>221</sup>

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219. Hall, *supra* note 179, at 493–94.

220. Early in the twentieth century, courts began to conclude that even a successful physician treatment or surgery could constitute a battery if performed without the consent of the patient. *See, e.g., Pratt v. Davis*, 118 Ill. App. 161 (Ill. App. Ct. 1905); *Schloendorf v. Society of New York Hosp.*, 105 N.E. 92 (N.Y. 1914).

221. *See Michelle Oberman, Mothers and Doctors' Orders: Unmasking the Doctor's Fiduciary Role in Maternal-Fetal Conflicts*, 94 NW. U. L. REV. 451, 464–66 (2000) (discussing genesis of informed consent obligation).



The permission of the patient is considered meaningful only if the patient is first provided with the information that a reasonable person would want when making the decision.<sup>222</sup> Informed consent assumes that the patient is an autonomous individual given rights by the legal system to protect her from physician overreaching. Scholars cannot seem to agree on whether informed consent enhances or diminishes doctor-patient trust. Richard Sherlock seems to think that informed consent laws detract from patient-physician trust.<sup>223</sup> While emphasizing the importance to trust of being informed, he questions whether the shared decision making that informed consent law envisions contributes to patient trust in their physicians.<sup>224</sup> First, he views the language of rights and the language of trust as fundamentally at odds with one another.<sup>225</sup> One need not resort to rights in a relationship of trust. Moreover, most patients want to turn their care over to their physicians as part of a ritual of trust that assists them psychologically in their time of need. Sherlock points out that in a study performed at the University of Pittsburgh, only about ten percent of patients in inpatient surgery and cardiology wards expressed a desire to participate in shared decision making.<sup>226</sup> In a separate study conducted on patients at an outpatient hypertension clinic, nearly seventy percent of the patients agreed to cede at least some decision making authority to the physician.<sup>227</sup> Sherlock concludes that to restore faith in the physician-patient relationship, the law should focus on the provision of information rather than the sharing of decision making.<sup>228</sup>

By contrast, our trust analysis earlier in this Part suggests that informed consent can serve a trust-enhancing function by empowering the patient to decide how much safety net is needed in order for her to feel comfortable proceeding with treatment. Indeed, our analysis suggests that overall informed consent plays either a neutral or a positive role in building patient trust. First, we must separate sick from well patients when considering patient reactions to informed consent. The empirical evidence does suggest that most sick patients want no part in shared decision making, but it is far from clear that we should assume that being offered

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222. *See id.* at 465 (“Beginning in the 1950s, courts found that treating patients without first informing them of the risks, benefits, and alternatives to treatment constituted negligence.”) (citing cases).

223. Richard Sherlock, *Reasonable Men and Sick Human Beings*, 80 AMER. J. MED. 2 (1986).

224. *Id.* at 4.

225. *Id.* at 3.

226. *Id.* at 2.

227. *Id.*

228. *Id.* at 4.

the possibility of shared decision making reduces patient trust.<sup>229</sup> A doctor can easily “agree” with the patient that the forms are mere bureaucratic formalities imposed by outsiders yet ask the patient to help the doctor complete the forms. Moreover, a patient whose first reaction is avoidance of shared decision making might learn something about the treatment options that ends up convincing her that she does have an opinion regarding how to proceed. Even if she has no such opinion and feels strongly that she does not want to form one, she can simply sign the form. Healthy patients, by contrast, are probably much more likely to want to know the treatment options and the risks involved with each course of action. For new patients who have not yet developed a sense of strong trust in the physician, the informed consent process can provide information to the patient about the judgment and the values of the physician, and this information can help the patient in determining whether the doctor can be trusted to serve her needs.<sup>230</sup> When healthy patients do not wish to participate in shared decision making, the doctor again can blame the bureaucratic process on the outsiders.

Separately, there is little reason to believe that an externally imposed bureaucratic process will affect the doctor-patient relationship.<sup>231</sup> One might argue that the requirement signals to the patient that doctors in

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229. See Elizabeth Dugan et al., *How Patients' Trust Relates to Their Involvement in Medical Care*, 54 J. FAM. PRAC. 344 (2005) (finding that trust is compatible with both involved and deferential styles of patient decision making).

230. An exception to our general position must be articulated, however. If a doctor's informed consent process reveals that the doctor has little experience in performing a potentially life-threatening procedure, then trust in that physician to properly perform that procedure could be threatened. And that trust reduction would presumably be experienced by both old and new patients. See Mark A. Hall, *Caring, Curing and Trust: A Response to Gatter*, 39 WAKE FOREST L. REV. 447, 450 (2004) (discussing problem).

231. The analysis in this section assumes, perhaps simplistically, that the duty of informed consent does not extend beyond a duty to inform the patient of the varying treatment options as well as the risks and prognoses associated with each option. It does not take into account other obligations that might be added to a duty to inform the patient such as a duty to inform the patient about the financial incentives imposed on the physician by a health care organization. See William M. Sage, *Regulating Through Information: Disclosure Law and American Health Care*, 99 COLUM. L. REV. 1701, 1750–51 (1999) (discussing possibility that informed consent obligations could extend to disclosure of physician compensation arrangements and other financial interests). Imposing a duty to disclose this information might affect patient trust. See David Mechanic & Mark Schlesinger, *The Impact of Managed Care on Patients' Trust in Medical Care and Their Physicians*, 275 JAMA 1693 (1996) (arguing that disclosure to patients of fee structures in managed care plans might well create distrust on the part of patients who are then made aware of the fact that the doctor is more likely to ration care and less likely to refer the patient to a specialist under the plan); see also Hall et al., *supra* note 6, at 314 (reporting significant association between reported trust levels and membership in managed care). But another study by Mark Hall found that disclosing HMO financial incentives in one trial did not decrease trust and may have increased it. Mark A. Hall, *How Disclosing HMO Physician Incentives Affects Trust*, 21(2) HEALTH AFF. 197 (Mar. 2002).

general are untrustworthy,<sup>232</sup> but more likely, the interpersonal dynamic between doctor and patient swamps this weak symbolic effect.<sup>233</sup> Moreover, assuming that the informed consent requirement does signal that doctors can be untrustworthy, the patient's strong emotional desire to place the decision back into the doctor's hands could actually intensify her feelings of trust in her doctor. However, it is not entirely clear that informed consent does signal to patients that doctors can be untrustworthy. The physician-patient dialogue might instead work to convince the patient that the doctor cares for the welfare of the patient and respects the patient's preferences. In short, a nuanced understanding of patient trust suggests that informed consent laws are unlikely to interfere with patient trust in doctors.

### (3) *Duty to Treat*

How might a duty to treat influence patient trust in physicians? As a general common law matter, doctors can deny treatment to any patient with whom they prefer not to deal.<sup>234</sup> Moreover, doctors can even terminate treatment of current patients in the middle of a treatment process, although they do have an obligation to give the patient an adequate opportunity to find an alternate physician.<sup>235</sup> This right to refuse treatment is mitigated by both an ethical obligation to provide care in the event of an emergency and a legal obligation not to discriminate on the basis of race, religion, national origin, ethnicity, disability, etc., in the

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232. Cf. Hall, *supra* note 179, at 492 (asserting that publicity in malpractice cases can cast "seeds of doubt about all physicians").

233. Adding to the relatively weak signaling effect are the facts that (1) physicians seem to enjoy considerable discretion in how risk information is conveyed; and (2) patients tend to poorly process and understand the information that is conveyed to them. See Peter H. Schuck, *Rethinking Informed Consent*, 103 YALE L.J. 899, 933-34 (1994) (discussing problems regarding utility of informed consent).

234. Doctors do not even have a common law duty to treat patients in an emergency. VICTOR E. SCHWARTZ ET AL., PROSSER WADE AND SCHWARTZ'S TORTS: CASES AND MATERIALS 414 (10th ed. 2000) (citing classic case of *Hurley v. Eddingfield*, 59 N.E.2d 1058 (1901)).

235. In general, a physician has an obligation to continue to provide treatment until the patient no longer requires care for the affliction that required treatment. Maxwell J. Mehlman, *The Patient-Physician Relationship in an Era of Scarce Resources: Is There A Duty to Treat?*, 25 CONN. L. REV. 349, 373 n.83 (1993). However, case law suggests that a doctor can terminate a relationship by giving the patient notice of the termination and a reasonable opportunity to obtain care elsewhere. See *Payton v. Weaver*, 182 Cal. Rptr. 225 (Cal. Ct. App. 1982) (physician not required to continue to treat disruptive, abusive, and unreasonable kidney failure outpatient even if no other outpatient clinic would treat her, though care still provided at hospital on emergency basis); *Capps v. Valk*, 369 P.2d 238 (Kan. 1962); *McGulpin v. Bessmer*, 43 N.W.2d 121 (Iowa 1950); *Johnson v. Vaughn*, 370 S.W.2d 591 (Ky. Ct. App. 1963); *Ricks v. Budge et al.*, 64 P.2d 208 (Utah 1937).

provision of medical care.<sup>236</sup> These limitations may serve trust-enhancing functions.<sup>237</sup> Consider first the ethical limit on the doctor's right to refuse treatment to a patient during an emergency.<sup>238</sup> We suggested earlier that simply knowing one has a doctor who will do her best to help the patient can produce its own health benefits and that those health benefits result from the patient's feelings of trust in her doctor. This placebo effect is likely strongest when the patient is most in need of physician assistance. If so, then an ethical obligation to render assistance in an emergency will likely produce significant additional benefits for the patient. Moreover, the ethical obligation enables doctors to avoid problems that a legal rule could create. Most notably, a legal right to emergency assistance would extend to all patients needing emergency care, regardless of the doctor's other patients' needs, and regardless of the number of patients requiring emergency care. The ethical obligation requires no more than that the physician render services to the best of his ability, a standard with ample room for flexible application.<sup>239</sup> Moreover, there is some belief that ethical obligations are more likely to create an internalized sense of trustworthiness than will legal rules.<sup>240</sup> Given this possibility, and the fact that crafting a legal rule creates pragmatic difficulties, the ethical rule might be the best mechanism for encouraging doctors to give emergency assistance.<sup>241</sup>

Consider next the legal limitations on the doctor's refusal to treat patients. Civil rights statutes prohibit doctors from refusing to treat patients when the patients are denied treatment because they are members of a protected class. For example, the Civil Rights Act of 1964 makes it unlawful for physicians and hospitals receiving federal funds to

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236. See *infra* notes 242–44 and accompanying text.

237. We do not mean to suggest here that the sole or even the primary purpose of these limitations is to enhance trust. We merely note the connection between the limitations and the trust of the patient in his physician.

238. See American Medical Association's Principles of Medical Ethics, No. V (2001) (providing that in an emergency the doctor should render aid to the best of his ability), available at <http://www.ama-assn.org/ama/pub/category/2512.html>.

239. *Id.*

240. Cf. Hall, *supra* note 179, at 510 (noting that a heavily regulatory legal regime might undermine the perception and reality of trustworthiness in the doctor-patient relationship by crowding out intrinsic motivation).

241. Most hospitals have a legal duty to render emergency services to all who request those services. Emergency Medical Treatment and Active Labor Act, 42 U.S.C. § 1395dd (2000) (requiring hospitals that receive Medicare funds to treat all emergency patients, at least to the point of stabilizing the patient's medical condition). This obligation could help mitigate any harm that might result from the physicians' legal ability to refuse emergency treatment.

discriminate on the basis of a person's race or national origin.<sup>242</sup> Other state and federal civil rights statutes further prohibit physicians from discriminating on the basis of disability, gender, or religion.<sup>243</sup> In addition, as part of the Americans with Disabilities Act, physicians are apparently unable to refuse to treat a patient on the grounds that she is HIV positive.<sup>244</sup> Lois Shepherd has argued that by enabling a doctor to refuse to treat or to terminate the care of any patient, the trusting relationship between the doctor and the patient is impeded.<sup>245</sup> Shepherd's concern is that a patient is less likely to reveal personal information relevant to treatment if she knows that the doctor could terminate her treatment on the basis of that information.<sup>246</sup> Furthermore, a patient who anticipates being discriminated against might defer consulting with a physician altogether out of fear that she will be treated poorly or rejected as a patient. Both sets of concerns appear to be well supported in reality. Doctors complain that it is difficult to get patients to be honest about their consumption of alcohol and drugs and their sexual practices.<sup>247</sup> Gay and lesbian individuals often postpone or avoid seeking medical treatment out of fears about the treatment they will receive from their physicians.<sup>248</sup> Moreover, there is some evidence, though admittedly disputed, that African Americans as a group trust their doctors less than do white patients.<sup>249</sup> To the extent that groups find themselves discriminated against by doctors, the members of those groups are likely to have less trust in physicians as a class and are

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242. Civil Rights Act of 1964, Pub. L. No. 88-352, Title VI, § 601, 78 Stat. 252 (1964).

243. Lois Shepherd, *HIV, the ADA, and the Duty to Treat*, 37 HOUS. L. REV. 1055, 1084–85 (2000).

244. See *Bragdon v. Abbott*, 524 U.S. 624 (1998). The Supreme Court ruled that a dentist could violate the ADA by refusing to treat a patient who was HIV positive but left open the possibility that the dentist's refusal would be justified if it could be objectively determined that treating or accommodating the HIV positive patient would create a significant health risk for the dentist or another. On remand, the trial court and court of appeals both determined that the dentist had not met his burden of establishing that a health risk existed. *Abbott v. Bragdon*, 163 F.3d 87 (1st Cir. 1998). In addition, the American Medical Association, the American College of Physicians, the American College of Surgeons, the Infectious Diseases Society of America, and the Association of American Medical Colleges have all supported the creation of an ethical duty to treat HIV-positive individuals. Shepherd, *supra* note 243, at 1084 & n.131.

245. Shepherd, *supra* note 243, at 1095–98.

246. *Id.*

247. Holly Pevzner, *Lies You Shouldn't Tell Your Doctor*, PREVENTION, Apr. 2001, at 130.

248. Danny Feingold, *Treatment, Not Judgment: A Gay-Specific Medical Group Has Opened for Those Who Fear Discrimination*, Los Angeles Times, Oct. 12, 1998, at S3.

249. Compare M. Gregg Bloche, *Trust and Betrayal in the Medical Marketplace*, 55 STAN. L. REV. 919, 943–45 (2002) (claiming that there are racial disparities in patient trust in their physicians) with Hall, *supra* note 179, at 507 n.181 (asserting that although race has been found to have a statistically significant relationship with trust, the findings are not consistent and the differences in trust levels are not very large).

likely to be more reticent to seek medical attention. For this reason (as well as others) it makes sense to limit doctors' ability to discriminate against suspect classes of patients. In addition to those classes already identified in the civil rights statutes mentioned, this trust concern also justifies a prohibition on discrimination on the basis of sexual orientation as well as a prohibition on discrimination on the basis of drug and alcohol addiction.

Shepherd would take the argument further, however, and impose on doctors an across-the board duty to treat unless the physician articulates a justifiable reason for his refusal.<sup>250</sup> The rationale for the general duty seems to be that all will trust their physician less if they know that he can refuse to treat them on the basis of personal animosity. Given the very high levels of trust that patients have in their doctors, however, it is not clear that the contours of the duty to treat enter into the minds of those not generally discriminated against as a class. A hypothetical possibility that the doctor might someday turn a patient away should not keep the patient from seeking care and providing personal information. Moreover, once a trusting relationship between physician and patient is established, the trust in that relationship will likely swamp the effects of any legal right to turn the patient away.

The actual termination of treatment by a physician might be viewed by the patient as a betrayal of trust which could produce psychological harm. It is by no means clear, however, that forcing doctors to continue to treat patients will in all circumstances aid in the enhancement of the patient's trust. A doctor who feels personal animosity toward a patient, however unjustified, is unlikely to exhibit a bedside manner with the patient that is conducive to the continuation of a strong trust. Given that bedside manner is the most significant determinant of patient trust in her physician,<sup>251</sup> forcing a doctor to treat a patient when there are realistic alternative care providers<sup>252</sup> might create a significant reduction in the patient's trust. A sick patient might resist seeking an alternative physician for some time, and for those patients, a lack of trust in the doctor could literally prove deadly. However unpleasant the withdrawal from treatment is, a sick

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250. Shepherd, *supra* note 243, at 1098.

251. See Hall et al., *supra* note 181, at 628 ("The strongest predictors of trust are physician personality and behavior. Patient trust is consistently found to be related to factors such as physicians' communication style and interpersonal skills.").

252. At least one court has found that a medical group could not refuse treatment to a patient who had urged an investigation of one of the group's physicians when the nearest alternative medical group was more than one hundred miles away. *Leach v. Drummond Medical Group, Inc.*, 192 Cal. Rptr. 650 (Cal. Ct. App. 1983).

patient might well be better off being forced to switch to a doctor who does not feel personal animosity toward the patient.

A nondiscrimination rule would, then, seem indicated, but not a rule requiring justification of any termination of treatment. A nondiscrimination rule encourages individuals systematically discriminated against to seek and receive meaningful medical care in the first instance; the benefits to such individuals of obtaining early and preventative medical care probably outweigh the temporary costs of receiving care from a seemingly uncaring doctor. Individuals who are not members of these groups will not, we think, be reluctant to seek medical care knowing a doctor is able to discontinue treatment. Instead, we should be more concerned about the forced continuation of treatment by the doctor. All of these concerns should be taken into account in the broader analysis of laws dealing with the duty to treat.

#### *(4) Summary*

In summary, people seeking medical care, especially those who are sick, are inclined to overtrust their doctors; they are apt to think their care is of high quality whether or not it is. If this overtrust carried the potential of causing harm to patients without any mitigating benefits, then we would expect laws designed to cause patients to recalibrate patient trust. For example, policymakers could set a goal for factors that affect the quality of health care such as length of office visit, total number of active patients, mortality rate, etc., and require doctors to communicate to patients each year in detail both the current medical goals for each factor and information about how the doctor's practice stands relative to the target numbers. Rather than arming patients with information designed to encourage them to make specific trust assessments, however, legal and institutional policies instead strive to encourage doctors to practice in ways that improve health outcomes (subject to cost concerns). The reluctance to encourage patients to make more accurate trust assessments stems in part from the fact that much patient trust is residual and therefore small adjustments are difficult, and in part from the fact that patient trust produces important health benefits.

Understanding the residual and sticky nature of much patient trust also helps us better understand how patient trust fits into current policy debates. Patient trust is likely unaffected by indirect measures such as negligence law standards and liability caps. Rather, to influence patient trust legal rules must be targeted to the relationship itself. Even then, legal measures likely have their greatest effect on new, healthy patients who are

better able to make specific trust assessments regarding doctors. Contrary to the assertions of some trust scholars, informed consent laws carry the potential of improving patient trust. A prohibition on discrimination against members of classes who have been discriminated against in medical treatment can enhance patient trust, whereas a blanket duty to treat could increase the harmful effects of patient trust. We now turn to an analysis of trust between corporate officers and directors.

## 2. *Corporate Directors*

### a. *Corporate Scandals and Director Monitoring*

Corporate scandals have been making headlines for the past few years. Many executives have been indicted; some have been convicted or pled guilty.<sup>253</sup> In Enron, one of the most scandal-ridden companies, thirty-four people were indicted; sixteen pled guilty and eight were convicted, including Ken Lay, the CEO, who died before he could be sentenced. Of the remainder, most are still involved in legal proceedings.<sup>254</sup> As the recent spate of financial scandals such as Enron, WorldCom, Global Crossing, and Adelphia demonstrates, director monitoring has not led to either the prevention or the discovery of extremely serious misdeeds—misdeeds serious enough to put some of the companies at issue, including these four, into bankruptcy.<sup>255</sup>

In most cases involving the scandal-ridden companies, corporate officers benefited enormously from cooking the corporate books.<sup>256</sup> Because officers' compensation packages included massive option grants, raising the corporation's stock price for the short to moderate term could, and did, yield payouts in the hundreds of millions of dollars.<sup>257</sup> Significant self-dealing has also been uncovered.<sup>258</sup> In some cases, directors too were

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253. Carrie Johnson & Ben White, *No Safety at the Top For Corporate Leaders*, WASH. POST, July 9, 2004, at A01.

254. See *Prosecution Scorecard*, Chron.com Special Report on Enron, available at <http://www.chron.com/news/specials/enron/background.html#scorecard> (last visited Nov. 6, 2006).

255. See, e.g., Faith Stevelman Kahn, *Bombing Markets, Subverting the Rule of Law: Enron, Financial Fraud, and September 11, 2001*, 76 TUL. L. REV. 1579, 1587 (2002).

256. As Troy Paredes writes: "In short, Enron's collapse boiled down to massive accounting fraud and irregularities . . . In addition to, and perhaps motivating, the financial manipulations were a number of suspect conflict-of-interest transactions involving members of Enron's management." Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 495, 503 (Nancy B. Rapoport & Bala G. Dharan eds., 2004).

257. See, e.g., William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1305 (2002).

258. See generally WILLIAM C. POWERS, JR. ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP., (Feb. 1, 2002)



benefiting personally. In one notorious case, Frank Walsh, a director of Tyco, had a secret agreement with the company's CEO, L. Dennis Kozlowski, to receive payment of a \$20 million "Finder's Fee" in connection with Tyco's acquisition of The CIT Group.<sup>259</sup> In most cases, however, the big payouts went to corporate officers.<sup>260</sup> Directors' main failing seem to have been a failure to properly monitor the officers,<sup>261</sup> which implicates their fiduciary duty of care.<sup>262</sup>

As a result of these scandals, corporate governance has come under intense scrutiny. Far-reaching changes to the regulatory regime, such as the Sarbanes-Oxley Act,<sup>263</sup> have already been adopted,<sup>264</sup> and more changes are being considered.<sup>265</sup> Various organizations have adopted or

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[hereinafter POWERS REPORT], available at 2002 WL 198018; THE ROLE OF THE BOARD OF DIRECTORS IN ENRON'S COLLAPSE: REPORT PREPARED BY THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE, S. REP. NO. 107-70 (2002) [hereinafter SENATE REPORT], available at 2002 WL 32002180; Kristen Hays, *Fastow Aide to Learn His Fate Today*, HOUSTON CHRON., Nov. 17, 2006, available at <http://www.chron.com/disp/story.mpl/special/enron/4341327.html>. See also Paredes, *supra* note 256, at 503.

259. See *SEC Sues Former Tyco Director and Chairman of Compensation Committee Frank E. Walsh, Jr. for Hiding \$20 Million Payment From Shareholders*, SEC Release 2002-117 (Dec. 17, 2002), available at <http://www.sec.gov/news/press/2002-177.htm> (last visited Apr. 17, 2004); Andrew Ross Sorkin, *Former Director of Tyco Fined Board Member Pleads Guilty to Fraud, Settles*, S.F. CHRON., Dec. 18, 2002, available at <http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2002/12/18/BU166429.DTL&type=business>.

260. See Bratton *supra* note 257.

261. Paredes's list of the Enron board's failings include: (1) approving conflicted transactions involving Fastow, Enron's CFO; (2) failing to understand those transactions; and (3) not exercising sufficient oversight to ensure the accuracy of financial statements and adequacy of disclosure. Paredes, *supra* note 256, at 508.

262. Directors and officers of a corporation owe fiduciary duties of care and loyalty to the corporation and its shareholders. See, e.g., WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATIONS AND FINANCE: LEGAL AND ECONOMICS PRINCIPLES*, 154-64 (9th ed., 2004). Directors' fiduciary duties include the duty to monitor the officers. *Id.* Directors' duties are traditionally considered to consist of monitoring and strategic oversight. *Id.*

263. Sarbanes-Oxley Act (Public Company Accounting Reform and Investor Protection Act), 15 U.S.C. §§ 7201-7266 (Supp. 2003).

264. While many, and probably most, commentators refer to SOX as far-reaching, one commentator believes it does little more than recodify existing laws and regulations. Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 918-19 (2003).

265. The literature discussing possible corporate governance solutions in the wake of Enron is voluminous. See, e.g., Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233 (2002); John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269 (2004); Bratton, *supra* note 257; Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L. J. 797, 801-02 (2001) [hereinafter Langevoort, *Corporate Boards*]; Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003).

are considering adopting corporate governance codes of best practices.<sup>266</sup>

One important focus of proposed corporate governance changes is increasing the effectiveness of director monitoring.<sup>267</sup> To that end, significant emphasis is being placed on assuring and increasing the independence of the board. The rationale is that directors who are not independent may be less apt to scrutinize management closely or, perhaps, may even approve of arrangements that benefit management at the expense of the company.<sup>268</sup> Accordingly, the New York Stock Exchange (NYSE) and the NASDAQ will now require companies listed thereon to have boards that consist of a majority of independent directors.<sup>269</sup> Further, they will require independent directors to have several meetings outside the presence of management.<sup>270</sup> The NYSE also will require each listed company to have a nominating/corporate governance committee composed entirely of independent directors.<sup>271</sup> The compensation committee as well would be composed entirely of independent directors, as would the audit committee.<sup>272</sup> The NASDAQ requirements are largely similar.<sup>273</sup> Moreover, the definition of independence is becoming progressively more restrictive; many directors who might have counted as independent under more expansive definitions will no longer do so. In this regard, both the

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266. See generally *Recommendations From The National Association Of Corporate Directors Concerning Reforms in the Aftermath of the Enron Bankruptcy*, May 3, 2002, available at [http://www.nacdonline.org/nacd/enron\\_recommendations.asp](http://www.nacdonline.org/nacd/enron_recommendations.asp).

267. To be sure, some commentators think the failing is more that of parties other than the board. See, e.g., John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 *BUS. LAW.* 1403 (2002); JOHN C. COFFEE JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* (2006); Jill E. Fisch and Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 *VILL. L. REV.* 1097, 1109–10 (2003); see also Jonathan R. Macey, *Efficient Capital Markets, Corporate Disclosure, and Enron*, 89 *CORNELL L. REV.* 394 (2004). Whether or not other parties should have discovered the difficulties, the boards certainly were not vigilant monitors. See generally *SENATE REPORT*, *supra* note 258, at 59.

268. See, e.g., Leo E. Strine, *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 *BUS. LAW.* 1371 (2002); Charles M. Elson, *Executive Compensation, the Duty of Care, Compensation, and Stock Ownership*, 63 *U. CIN. L. REV.* 649 (1995).

269. New York Stock Exchange, *Listed Company Manual*, § 303A(1) (Nov. 4, 2003), available at <http://www.nyse.com/lcm/1078416930879.html?archive=no> (last visited Sept. 27, 2004).

270. See generally *NASD and NYSE Rulemaking: Relating to Corporate Governance*, SEC Release No. 34-48745 (Nov. 4, 2003), available at <http://www.sec.gov/rules/sr03/34-48745.htm> (last visited Sept. 27, 2004).

271. *Id.*

272. *Id.*

273. *Id.* The NASDAQ rules would also require a majority-independent board. They would require that nominees for director be selected by a process that assures significant participation by independent directors. They also would generally require the audit committee to be composed exclusively of independent directors. *Id.* WorldCom's monitor's report suggests that *all* directors be independent, other than the CEO. See Breeden, *infra* note 306.

NYSE and the NASDAQ have adopted very detailed guidelines for determining independence.<sup>274</sup>

Private monitoring efforts are adding to the pressures for increased independence. A well-known shareholder activist, Nell Minow, is promoting software that reveals the extent of interconnectedness between board members and officers of various companies.<sup>275</sup>

More recently, the Securities and Exchange Commission (SEC) proposed allowing shareholders to nominate directors to be considered for election at the corporation's expense under certain circumstances.<sup>276</sup> Shareholders have always had the power to nominate directors, but the election process is quite expensive because a great deal of material has to be supplied to all the shareholders.<sup>277</sup> The corporation—that is, the officers who act for the corporation—is able to propose its chosen slate at the corporation's expense, but currently shareholders must use their own resources to proffer alternate nominees. The SEC proposal would allow shareholders to include their director-nominees on the same materials as those of the corporation if a significant proportion of the corporation's shareholders had shown dissatisfaction with the existing board.<sup>278</sup>

Underlying all of these efforts is the presumption that non-independence was the main problem causing directors to monitor

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274. See *NASD & NYSE Rulemaking*, *supra* note 270. A slightly older definition of independent director is from the Council of Institutional Investors: "Directors whose only nontrivial professional, familial or financial connection to the corporation or its CEO is their directorship. Directors who are not considered independent under the Council's definition are: executives of the company; paid advisers or consultants of the company such as lawyers, accountants and bankers; employees of a significant customer or supplier; anyone with a personal services contract with the company or the CEO; anyone affiliated with a foundation, university or other non-profit organization that receives significant grants or endowments from the company; relatives of the CEO or other executives of the company; and those who are part of an interlocking directorate (where the CEO or other executive serves on the board of the company that employs the director)." See Council of Institutional Investors, *Shareowner Initiative Glossary*, at [http://www.cii.org/dcwascii/web.nsf/doc/members\\_glossary\\_i.cm](http://www.cii.org/dcwascii/web.nsf/doc/members_glossary_i.cm), (last visited Sept. 27, 2004). The definition also includes lookback criteria under which they continue to define directors as non-independent for five years after the director's affiliation with the company ceased. *Id.*

275. See generally *The Corporate Library*, <http://www.boardanalyst.com/index.asp?p=prodserv&s=psndit> (last visited Nov. 17, 2006).

276. See <http://www.sec.gov/spotlight/dir-nominations.htm> (last visited Apr. 20, 2005) (contains links to the proposing release, the Roundtable discussing the proposal, and other pertinent documents).

277. See generally ROBERT W. HAMILTON, *THE LAW OF CORPORATIONS* 404–05 (5th ed. 2000).

278. The maximum number of shareholder-nominated directors would be less than fifteen percent of the total board. See <http://www.sec.gov/spotlight/dir-nominations.htm>, *supra* note 276. The SEC's proposal has been very controversial, and the SEC website page contains links to many critiques. The proposed rule apparently has no chance of passing in its current form. Ben White, *SEC Chief Says Proxy Rule Needs Rewriting, Donaldson Holds Hope for Changes During His Tenure*, WASH. POST, Feb. 10, 2005, at E03. See also *SEC's Open Ballot Proposal Officially Dead*, <http://corp.gov.net/news/archives2005/Jan-Feb.html> (last visited Apr. 20, 2005).

ineffectively at Enron, WorldCom, Global Crossing, Adelphia, and the other scandal-ridden companies, with lack of expertise, lack of time, and perhaps outsiders' inability to express their views outside the hearing of inside directors playing a smaller role.<sup>279</sup> But many of the companies had majority-independent boards (and some with considerable expertise).<sup>280</sup> Indeed, the boards were in many cases "exemplary," at least in theory.<sup>281</sup> Enron, for example, had in 2001 fourteen board members, only three of which (Lay, Jeffrey Skilling, and Robert Belfer) were employees or former employees of Enron; the remaining members were largely well-respected outsiders, among them Robert Jaedicke, an emeritus accounting professor and former dean of the Stanford Business School, who headed the Audit Committee.

Commentators focusing on lack of independence as an important reason for defective monitoring argue that many of the purportedly independent directors had suspect ties to the companies on whose boards they sat.<sup>282</sup> The ties consisted principally of consulting fees and

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279. Consider in this regard the NYSE and NASDAQ requirements that independent directors meet without the inside directors, as discussed in the text accompanying *supra* note 270, and the provision of SOX requiring that each audit committee either have a financial expert or disclose that it does not. See Sarbanes-Oxley Act §§ 406–407, 15 U.S.C. § 7265 (Supp. 2003). As to lack of time: The National Association of Corporate Directors (NACD) recommends that directors with full-time positions should not serve on more than three or four other boards, while the Council of Institutional Investors suggests that directors with a full-time job should not sit on more than two other boards. See NATIONAL ASSOCIATION OF CORPORATE DIRECTORS, REPORT OF THE NACD BLUE RIBBON COMMISSION ON DIRECTOR PROFESSIONALISM 12 (1996). The Council of Institutional Investors, *Corporate Governance Policies* 4 (2006) has roughly comparable recommendations.

280. See, e.g., Paredes, *supra* note 256, at 504 (“[B]y all appearances, Enron’s board looked great.”); Gordon, *supra* note 265, at 1241 (“[Enron’s] board was a splendid board on paper: fourteen members, only two insiders. Most of the outsiders had relevant business experience, a diverse set including accounting backgrounds, prior senior management and board positions, and senior regulatory posts.”). See also Karl Hofstetter, *One Size Does Not Fit All: Corporate Governance For “Controlled Companies,”* 31 N.C. J. INT’L L. & COM. REG. 597, 628 (2006).

281. *Id.*

282. As to Enron, see, e.g., SENATE REPORT, *supra* note 258, at 8. See also POWERS REPORT, *supra* note 258, at 54–57; SENATE REPORT, *supra* note 258, at 41–45 (Finding (6)); Charles M. Elson & Christopher J. Gyves, *The Changing Role of Directors in Corporate Governance, the Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855, 871 (2003); Gordon, *supra* note 265, at 1242 (“It turns out that the independence of virtually every board member, including Audit Committee members, was undermined by side payments of one kind or another. Independence also was compromised by the bonds of long service and familiarity.”). For purposes of this article, we speak as though the problems at Enron and the other scandal-ridden companies resulted from manager opportunism. This is, of course, a simplification, as has been discussed in the literature. See, e.g., Bratton, *supra* note 257, at 1305; Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285 (2004). But a significant component of what occurred can be characterized as resulting from manager opportunism. Moreover, to the extent the opportunism was

contributions to charitable and other organizations with which the board members were affiliated.<sup>283</sup> As to Mr. Jaedicke, the chairman of the audit committee, the tie is said to be his long service as a board member.<sup>284</sup> As Delaware Chancellor Leo Strine points out: “After that period of time, it is only human for feelings of collegiality and kinship between the director and management to run rather deep.”<sup>285</sup> In short, many believe that purported independent directors are not really independent, and that the solution is to put more truly independent directors on the board.<sup>286</sup> As is generally acknowledged, independence comes at a cost: the more independent the board, the less knowledge about the company the board probably has. And there may be some diminution of collegiality in the board’s dealings with the officers.<sup>287</sup> Given that the board has to do more than just monitor—it also works on strategic oversight, for which it needs a collegial and cooperative relationship with the officers—these costs may not be trivial. Nevertheless, proponents of independence seem to think these costs are warranted.<sup>288</sup>

We think that increasing the proportion of independent directors, and defining independence more restrictively, likely will do little to prevent

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unconscious—managers having convinced themselves that self-benefiting actions actually were in the interest of the company—our analysis would apply with equal force.

283. For instance, one independent Enron director, Wendy Gramm, was affiliated with George Mason University’s Mercatus Center, to which Enron and the Lay Foundation donated more than \$50,000, while her husband, Senator Phil Gramm, received about \$100,000 in campaign contributions from Enron-affiliated sources. See Jay Root & Jennifer Autrey, *Power Couple: Sen. Phil Gramm and His Wife, Wendy, Have Deep Ties to Enron*, FT. WORTH STAR-TELEGRAM, Jan. 18, 2002, at 1A and 23A (citing Center for Responsive Politics); Nancy Benac, *Despite Their Ties to Energy Giant, Gramms Say They Got Burned, Too*, SEATTLE TIMES, Jan. 24, 2002, at A3; Maria Recio, *Gramm Lauds His Wife’s Role in Enron*, FT. WORTH STAR-TELEGRAM, Jan. 24, 2002, at 11. (citing Public Citizen as a source). In the five years preceding the collapse, Enron and Kenneth Lay donated nearly \$600,000 to the M.D. Anderson Cancer Center in Texas. In 1993, the Enron Foundation pledged \$1.5 million to the Cancer Center. Two Enron Board members, Dr. LeMaistre and Dr. Mendelsohn, had served as president of the Cancer Center. Other conflicts originated from consulting or legal work that Enron had with directors or their firms. See Christopher H. Schmitt, Julian E. Barnes & Megan Barnett, *One Cozy Bunch*, U.S. NEWS & WORLD REPT., Feb. 11, 2002, at 28.

284. Mr. Jaedicke was a member of the board for sixteen years, since 1985.

285. See Strine, *supra* note 268, at 1378; Gordon, *supra* note 265, at 1242; O’Connor, *supra* note 265, at 1263.

286. See *supra* notes 269–74 and accompanying text. See also SENATE GOVERNMENTAL AFFAIRS COMM., THE ROLE OF THE BOARD OF DIRECTORS IN ENRON’S COLLAPSE, S. PRT. 107-70 (2002) (“The Securities and Exchange Commission and the self-regulatory organizations, including the national stock exchanges, should . . . strengthen requirements for Director independence at publicly traded companies . . .”); see also Charles M. Elson, *Enron and the Necessity of the Objective Proximate Monitor*, 89 CORNELL L. REV. 496, 497 (2004); Gordon, *supra* note 265, at 1241.

287. See Jill Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265 (1997).

288. See, e.g., Paredes, *supra* note 256, at 520–21.

future Enrons.<sup>289</sup> It seems unlikely that the well-respected independent directors on the boards of scandal-ridden companies would have risked their reputations for the comparatively small benefit that renders their independence suspect. Income in the form of fees (or contributions to a favored charity) is a motivating factor for board member conduct, but often the amounts in question seem small relative to the expected cost of missing the scandals. Moreover, acquisition of reputational capital is an important benefit of board service; overlooking Enron-level misdeeds could not only limit the reputational capital acquired, but could even have reputational costs that would compromise future earnings possibilities.<sup>290</sup>

We offer an alternative explanation for director monitoring failings in Enron and the other scandal-ridden companies: overtrust of the officers.<sup>291</sup> What was the basis for this overtrust? One reason was presumably that the directors assumed that the officers were somewhat constrained for instrumental reasons—they would not want to suffer legal or reputational

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289. Other scholars have come to this conclusion as well, but their reasons differ from ours. Some argue that gatekeepers rather than boards bear the primary responsibility. See generally COFFEE JR., GATEKEEPERS, *supra* note 267. Others note that there's no empirical evidence that independent board produce better results. See, e.g., Bernard Black & Sanjai Bhagat, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231 (2002); Fisch, *supra* note 287, at 278–79. See also Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence*, 90 NW. U. L. REV. 898, 903–04 (1996). Another set of critiques warns more broadly against recipes for good governance. See, e.g., Jeffrey Sonnenfeld, *Good Governance and the Misleading Myths of Bad Metrics*, ACAD. OF MGMT. EXECUTIVE, 2004, Vol. 18, No. 1. Relatedly, Nell Minow, a prominent shareholder activist, argues that independent character—the willingness to question—is more important than formal “independence” as it is often defined. See National Investor Relations Institute and the Public Affairs Council, *Symposium on ‘Corporate Governance and Shareholder Activism’* (Dec. 12, 2002) [hereinafter Roundtable], available at [http://www.niri.org/news\\_media\\_center/speeches/NiriPacSympos20021212.pdf](http://www.niri.org/news_media_center/speeches/NiriPacSympos20021212.pdf) (last visited Sept. 27, 2004). Finally, Bebchuk & Fried argue that even “independent” directors will always be beholden to managers, if only to retain their jobs and the possibility of future advantageous fees and other arrangements. See LUCIAN AYRE BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 27–34 (2004).

290. See, e.g., Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1060 (1993) [hereinafter *Independent Directors*]. See also Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 577 (2003); Lin, *supra* note 289, at 917–18; Langevoort, *supra* note 265, at 804.

291. Note that while officers presumably would like to trust the directors, the officers aren't relying nearly as much on the directors' trustworthiness as the directors are relying on the officers'. We are not the first to suggest that directors should not have trusted the officers at such high levels. SENATE REPORT, *supra* note 258, at 8. See also O'Connor, *supra* note 265, at 1263; Joe Stephens & Peter Behr, *Enron's Culture Fed its Demise*, WASH. POST, Jan. 27, 2002, at A01. Like them, we can't offer much hard evidence that independent directors overtrust. Some anecdotal evidence for our view that directors overtrust exists: the Enron directors said that they had great respect for senior Enron officers, trusting their integrity and competence. SENATE REPORT, *supra* note 258, at 8. But we do not want to put too much weight on what may be a self-serving self-characterization by directors who may prefer to depict themselves as duped rather than depicting themselves as complicit.

sanctions.<sup>292</sup> But the directors must have thought the officers were constrained by more than instrumental motivations. Then, and even now, an officer's cost-benefit analysis might have argued in favor of wrongdoing: it is still not clear to what extent the officers involved in the various scandal-ridden companies will be punished, and many have benefited considerably.

Rather, the directors failed to look hard and well enough because they trusted too much in the officers. Directors started off with too much residual trust, which led them not to acquire trust-relevant information to form the correct assessments of where specific trust and distrust were appropriate.<sup>293</sup> They too readily approved large and complex transactions they did not understand; they did not ask searching questions that would have revealed the existence and extent of the problems. As a result, fraud and other wrongdoing were not discovered until the companies' deterioration was quite advanced—in some cases, to the point of bankruptcy.

Independent directors placed too much residual trust in the officers for at least two reasons. Many independent directors enter their positions knowing very little about the company. They must act while still at an informational disadvantage. This disadvantage may lead them to begin their tenure as director with high levels of trust in the corporate officers. Even for those without such an informational disadvantage, many factors weigh in favor of initial overtrust. Prominent among these factors is the overtrust tendencies of people in in-group relationships.<sup>294</sup> As many commentators have observed, many, and probably most, corporate directors, both outsiders and insiders, are from the same social and professional "group" as are corporate officers.<sup>295</sup> Many directors are

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292. The directors' own assessment of the likelihood of the officers getting caught is subsumed within this formulation.

293. Our account overlaps to some extent with other psychological accounts of why directors did not monitor more effectively, most notably the work of Don Langevoort. *See generally* Langevoort, *supra* note 265; Langevoort, *supra* note 282; O'Connor, *supra* note 265, at 1263. Our contribution is to more fully explain why directors monitored as poorly as they did, and set forth some policy ramifications of that explanation.

294. Corporate law scholarship commonly posits the existence of a "group" consisting of many, and probably most, officers and directors of major corporations. *See, e.g.,* Strine, *supra* note 265. The social science literature considers economic, social, cultural, and other similar ties and connections as contributing to a sense of group membership, but there is no precise specification that neatly fits directors and officers. In a sense, the definitions of [non-]independence we discuss in note 274 can be seen as a definition of the relevant group.

295. As Victor Brudney puts it, "[n]o definition of independence yet offered precludes an independent director from being a social friend of, or a member of the same clubs, associations, or charitable efforts as, the persons whose [performance] he is asked to assess." Victor Brudney, *The*

themselves CEOs or high executives, or friends of one or more officers, and they often belong to the same clubs, associations, and charities.<sup>296</sup> The “group” from which most officers and directors are drawn is of course not a family, but we might imagine that group members might trust one another initially far more than strangers would.<sup>297</sup> And there are of course the more specific business ties,<sup>298</sup> including membership on one another’s boards.<sup>299</sup> This in-group phenomenon is not surprising; notwithstanding the law’s requirement that directors be elected by shareholders, directors are in effect selected by the officers. Directors thus selected will therefore have high initial trust—and will need to make decisions before they might be able to process disconfirming evidence.

Moreover, directors’ residual overtrust of officers can be expected to continue at least to some extent as the relationship continues. Due to confirmation bias and other well-documented psychological mechanisms, directors are not apt to look for, and hence unlikely to find, evidence of untrustworthiness that causes them to update their trust assessments. Exacerbating the problem, management controls the information flow to boards. Moreover, there are well-known pressures favoring consensus and deference to management, including management’s control over many board benefits and continuation on the board itself.<sup>300</sup> Director overtrust of officers is exacerbated as well by group dynamics and peer pressure that commentators have discussed.<sup>301</sup> Directors therefore retain too much residual trust and do not acquire enough trust-relevant information to properly gauge the appropriate level of specific trust and distrust.

We need to stress the contrast between our account and the traditional account that focuses on lack of director independence. In the traditional

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*Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 613 (1982); see also Strine, *supra* note 268, at 1402 n.34.

296. See Lin, *supra* note 289, at 915–16.

297. That common group membership as between directors and officers can lead to less vigilant monitoring is a point frequently made. See, e.g., Langevoort, *supra* note 265; Strine, *supra* note 268, at 1377–78; Brudney, *supra* note 295, at 612–13. However, we present a different view than most commentators as to why common group membership leads to bad monitoring of the sort seen in Enron. See *infra* text accompanying notes 301–04.

298. See, e.g., *The Corporate Library*, *supra* note 275 (click on “Board Analyst” under “Products”).

299. Of course, there are many examples. See, e.g., Charles Gasparino, *Citigroup’s Weill Might Avoid Charges Over Faulty Research*, WALL ST. J., Dec. 18, 2002, at A1. And even the lawyers are part of the “group.” See Andrew Ross Sorkin, *Disney’s Lawyer, Mouseketeer’s Friend*, N.Y. TIMES, Apr. 18, 2004, at 6. Of course, some of these relationships would disqualify the board members at issue from being “independent” for regulatory or other legal purposes. See the definitions of independence cited in *supra* note 274.

300. See BEBCHUK & FRIED, *supra* note 289.

301. See O’Connor, *supra* note 265, at 1263–64; Langevoort, *supra* note 265, at 811.



account, directors know or are willfully blind to the officers' misdeeds on account of common group membership and various social pressures. In our account, by contrast, the mechanism is cognitive but not conscious: directors honestly believe they do not have to check for certain types of behaviors because they think or assume the officers are constrained by shared internal norms and values from engaging in those behaviors. Boards would do a far better job monitoring for serious financial misdeeds if they took seriously that such misdeeds might be occurring and marshaled expertise to figure out how best to look.<sup>302</sup> But because they overtrust, they don't think to look as much or as well as they could.<sup>303</sup> Standard psychological accounts complement ours in identifying reasons why directors were not vigilant enough to detect even egregious wrongdoing,<sup>304</sup> but such accounts do not lead to the best policy solutions. For instance, correcting directors' optimism bias might argue for increasing residual distrust, perhaps by increasing director liability for breaches of duty of care. But, as we will argue below, our account suggests that more distrust *of a particular type* is needed, and argues very much against encouraging too much distrust and, in particular, too much residual distrust.

*b. Policy Recommendations*

Given our diagnosis of the problem, what might be an appropriate solution? First, as we discussed above, the present push towards increasingly independent boards, with independence defined increasingly narrowly, should be limited. We think directors who might not meet the types of strong independence standards being argued for (and in some cases, adopted) are capable of being effective monitors. The recent spate of CEO dismissals, including that of Maurice Greenberg of AIG, provides some evidence for our view. As one author noted, "[t]he people who

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302. This is not to say that directors can or should become auditors. But they are charged with monitoring of financial reporting, and should be able at least to work effectively with auditors to uncover more fraud than they have uncovered to date. See Paredes, *supra* note 256, at 508; POWERS REPORT, *supra* note 258, at 162.

303. We do not suggest that directors' overtrust of officers was necessarily reckless, or even negligent, at the time when the scandals were developing. The recent pre-Enron history lacked known scandals of anywhere near this magnitude.

304. For instance, directors may unconsciously desire to avoid either having to make difficult and unpleasant choices or acknowledging previous mistakes in approving transactions or selecting a problematic CEO. See generally Langevoort, *supra* note 282, at 294–95. See also Lin, *supra* note 289, at 914; Bainbridge, *supra* note 290, at 1061; Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 CORNELL L. REV. 356, 377 (2004).

ultimately pushed [Greenberg] from power were . . . his hand-picked colleagues, people who had been with him, in some cases, for more than a decade. Many of them were also people he encountered in other high-powered orbits, and he donated generously to their favorite causes.”<sup>305</sup>

Efforts should be directed instead toward encouraging directors to develop and exercise the optimal level and kind of trust and distrust in the officers. Enough residual trust should be maintained to facilitate a cooperative relationship and avoid paralyzing paranoia, but trust-relevant information must nevertheless be acquired and processed. Put differently, directors should generally trust the officers but remain vigilant for (and not overlook) certain types of wrongdoing. Unlike patients’ residual trust of their doctors, directors likely can compartmentalize different types of trust and likely can accommodate specific distrust before it threatens to significantly diminish residual trust.

What follows is our assessment of the best way for directors to acquire a reasonable mix of residual trust and specific trust and distrust so as to enable them to be better monitors. Each of our suggestions taken by itself is uncontroversial; indeed, some are more developed versions of current trends, such as our support of an increased emphasis on director training.<sup>306</sup> But what is key is our emphasis on addressing the problem cognitively. The aggregate effect of our suggestions should be to improve director monitoring by helping directors acquire the optimal mix of residual and specific trust and distrust in the officers.

First, we think considerable emphasis should be placed on educating directors to make the appropriate inquiries. We do not mean to underestimate the difficulties of such a task, which are akin to those faced by courts trying to appraise the exercise of due care retrospectively. Because deciding what constitutes due care is very hard, courts have focused far more on process than on substance, looking for “enough” effort rather than “good” effort—hence the full employment act for investment bankers and for lawyers who document that boards deliberated

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305. See Gretchen Morgenson, *Charity Begins at the Board. Just Ask AIG*, N.Y. TIMES, Apr. 10, 2005 at 1. In this regard, it should be noted that boards have been quick to dismiss CEOs involved in options backdating scandals. See, e.g., Vinnee Tong, *Ex-CEO of Monster Worldwide Resigns from Board over Stock Options Investigation*, Oct. 30, 2006, available at <http://news.findlaw.com/ap/051/10-30-2006/e485000f8674b499.html>.

306. Several courses are offered by American universities. See Michael T. Harris, *Boot Camps for Boards*, THE CHIEF EXECUTIVE, Jan. 2002, Vol. 174; Richard C. Breeden, *Restoring Trust, Report to the Hon. Jed S. Rakoff, the United States District Court for the Southern District of New York on Corporate Governance for the Future of MCI, Inc.*, 54 (Aug., 2003), available at [http://www.nysd.uscourts.gov/rulings/02cv4963\\_082603.pdf](http://www.nysd.uscourts.gov/rulings/02cv4963_082603.pdf).

long enough on particular decisions.<sup>307</sup> All too often this procedural focus has left the underlying purpose of the procedures or training unsatisfied, as illustrated by the fairness opinion requirement stemming from the famous *Van Gorkom* case.<sup>308</sup> Despite these difficulties, many effective and useful precedents for due diligence exist, including checklists used by law firms in various sorts of transactions. While the checklists are more comprehensive than what would be appropriate for boards of directors, they do demonstrate that a checklist designed to ferret out information, rather than specifying mechanical steps that would give “cover” if a decision turns out badly, can be produced.

Moreover, due diligence procedures should be developed. Directors who comply with developed due diligence procedures should enjoy a safe harbor, giving rise to a presumption of due care and good faith that protects them from potential liability. Liability for violations of due care has traditionally been exceedingly rare;<sup>309</sup> still, the potential for liability, coupled with a safe harbor, could strongly influence behavior.<sup>310</sup> Due diligence could also serve an expressive and norm-shaping function;<sup>311</sup> companies that did not provide for their boards to use such procedures might be seen as signaling that they had something to hide. An additional incentive might be more attractive pricing for Directors’ and Officers’ liability insurance. Some evidence suggests that insurance companies are increasingly taking into account particular attributes of directors and

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307. See Erica Beecher-Monas, *Enron, Epistemology, and Accountability: Regulating in a Global Economy*, 37 IND. L. REV. 141 n.245 (2003). See also Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006); Strine, *supra* note 268.

308. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). Many, if not most, commentators think that fairness opinions cost corporations more than the benefit to shareholders of obtaining such opinions justify. *In re Caremark Derivative Int'l, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), is also seen by some critics as spawning practices whose costs exceed benefits to shareholders. See, e.g., Black et al., *supra* note 307; Strine, *supra* note 268. Once a court suggests a particular practice might reduce liability for directors and officers, they will have agency cost reasons to engage in that practice. Jeffrey Sonnenfeld has also criticized formulaic approaches to corporate governance more broadly. See Sonnenfeld, *supra* note 289.

309. See Black et al., *supra* note 307; Strine, *supra* note 268, at 1375–76.

310. The reaction to *Caremark*, 698 A.2d 959, suggests that this is possible. The court in *Caremark* approved a settlement even though it noted that there was a “very low probability that it would be determined that the directors of *Caremark* breached any duty. . . .” *Id.* Still, the case was followed by a veritable explosion of apparently well-attended seminars on “*Caremark* duties.” A recent Delaware case, *Stone v. Ritter*, essentially adopts *Caremark*, stating that *Caremark* “articulates the necessary conditions for assessing director oversight liability.” *Stone v. Ritter*, Del. Sup. Ct., Nov. 6, 2006, at 4.

311. See Blair & Stout, *supra* note 12. See also Edward B. Rock & Michael L. Wachter, *Law, Norms and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619 (2001) (arguing that the duty of care is and should be a non-legally enforced standard).

corporations in pricing their Directors' and Officers' liability policies.<sup>312</sup> Good due diligence procedures might constitute a favored attribute. Not only might the company get better pricing, it might also get an additional monitor that the procedures were being followed.<sup>313</sup>

Director due diligence procedures need to address officers' control of the information directors need in order to monitor effectively. As Don Langevoort points out, senior officers may engage in acquisitions and complex transactions precisely to make it more difficult for directors and third parties to figure out what the company is doing.<sup>314</sup> A greater emphasis on information flow to directors from sources other than the officers is therefore needed.<sup>315</sup> Sarbanes-Oxley now requires that companies' auditors report to their audit committee rather than company management.<sup>316</sup> History suggests that the provision may not work as intended; certainly, independent litigation committees who hired their own legal advisors have often reached precisely the conclusions the management would want.<sup>317</sup> But perhaps the Sarbanes-Oxley provision can foster the development of a norm whereby directors get more information from non-management sources. Certainly, due diligence

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312. See Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market*, at 5, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=909346](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=909346).

313. Apparently D&O insurers have not historically considered particular attributes of directors in pricing their insurance, although they are increasingly considering doing so. See generally INSURANCE: DIRECTORS AND OFFICERS LIABILITY § 23.15 (MATTHEW BENDER & COMPANY, INC., 2004). Insurance companies have considerable exposure under their D&O policies on account of both director and officer conduct in the scandals. See Randy Paar, *D&O Liability & Insurance 2004: Directors & Officers Under Fire*, in DIRECTORS AND OFFICERS INSURANCE (PLI Commercial Law and Practice Course Handbook Series 3198, June, 2004). All this being said, thus far, it appears that D&O insurers are not in fact monitoring the companies for which they provide D&O insurance. See Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' and Officers' Liability Insurer*, available at [http://papers.ssrn.com/SOL3/papers.cfm?abstract\\_id=946309](http://papers.ssrn.com/SOL3/papers.cfm?abstract_id=946309).

314. Langevoort, *supra* note 265, at 812; John Olson, *How to Make Audit Committees More Effective*, 54 BUS. LAW. 1097 (1999); Langevoort, *supra* note 282, at 296.

315. One of the most successful examples of director monitoring involved Sunbeam Corporation. The directors read an article in Barron's which made serious allegations about company performance. Attempts to get the CEO to explain the situation satisfactorily failed; the board then fired the CEO. The article's information may have come from a disgruntled employee. Conversation between Charles Elson, board member of Sunbeam, and author Hill (March 2002); See also John A. Byrne, *How Al Dunlap Self-Destructed*, BUSINESS WEEK, July 6, 1998, at 58. Perhaps employees should be encouraged to come to the board with their information. See Luigi Zingales, *Want to Stop Corporate Fraud? Pay Off Those Whistle-Blowers*, WASH. POST, Jan. 19, 2004, at B02.

316. Securities Exchange Act of 1934, § 10A(m)(2) (codified as amended at 15 U.S.C. § 78j-1(m)(2)).

317. One author has been told of several instances in which a lawyer hired as an independent advisor to an independent litigation committee was "told" quietly what advice he "ought" to give.

procedures should expressly encourage directors to seek out their own information sources under appropriate circumstances.

Trade groups or self-regulatory organizations could profitably have a significant role in helping craft or anoint as acceptable general due diligence guidelines. Apart from their expertise and any benefits of standardization, the perception that the guidelines came from external forces would offer an additional benefit: it would minimize the signal sent to particular officers that they were being distrusted. As the trust literature discussed earlier indicates,<sup>318</sup> the monitoring practices of directors will surely affect the actions of the officers.<sup>319</sup> If monitoring causes officers to believe that they are strongly distrusted by the directors, the officers might decide to live up (or more precisely, down) to that view when they are not being monitored. On the other hand, officers who feel fully trusted might behave opportunistically because they suffer no (or very low) expected penalties. Our proposal should motivate officers to behave well lest they be caught behaving badly, while not encouraging them to behave badly when they do not fear getting caught. Officers will know that directors may very well catch bad behavior—but they will also know that the directors are looking for the behavior because the availability of the safe harbor depends on them doing so. Our proposal therefore has the potential to minimize the potentially pernicious effects of trust and distrust.

We also favor the present trend of ensuring that the board has the appropriate expertise.<sup>320</sup> The value of expertise is intuitive and obvious, but our framework suggests another advantage: people with expertise are better able to rely on their knowledge to trump excessive or misattributed emotions that can trigger heuristic, and therefore less careful, reasoning processes.

Board expertise will not suffice; the expertise must be properly employed. One solution may be to “assign” each board member particular

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318. See *infra* Part III.B (discussing fact that distrust tends to provoke untrustworthy behavior by trust target).

319. There is conflicting work on how people react to scrutiny; one line of scholarship suggests that people who know they are being scrutinized behave better, and another line suggests that scrutiny crowds out the motivation to be trustworthy. See David Dickinson & Marie-Claire Villeval, *Does Monitoring Decrease Work Effort? The Complementarity Between Agency and Crowding-Out Theories* (IVA Discussion Paper No. 1222, July 2004). On crowding out, see generally Iris Bohnet, Bruno S. Frey & Steffen Huck, *More Order with Less Law, Institute for Empirical Research in Economics* (University of Zurich Working Paper Series, July 2000).

320. The professional director idea, discussed in the 1990s and recently revived, see, e.g., Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 883–92 (1991), has considerable appeal to us because it fosters expertise.

responsibilities based on her expertise.<sup>321</sup> At least part of the reason such a procedure may work is that it visibly assigns to the “experienced” director the job of using her expertise.<sup>322</sup> The assignment itself, and its visibility, should assist the director in more accurately updating her initial assessments. However, assigning specific directors responsibility for particular areas might cause the other directors to minimize their scrutiny of those matters; if the “expert” missed a problem, it would not be caught. To address this issue, the safe harbor discussed above could require some level of scrutiny by all directors into even the “expert” specialized areas.

What about enhanced director liability for failure to monitor, or in corporate law parlance, breach of the duty of care? The likelihood that a director in violation of her duty of care will suffer any actual liability has historically been exceedingly small.<sup>323</sup> We think that the window of actual liability for breaches of the duty of care should remain small.<sup>324</sup> A larger window might encourage costly and inefficient levels of residual distrust, where directors are overly motivated to “look for everything” and officers, feeling distrusted, are more apt to behave in an untrustworthy manner. But we favor what seems to be the current trend, the imposition of reputational

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321. See David A. Nadler, *Building Better Boards*, HARVARD BUS. REV., May 2004, at 102, 108. Nadler discusses a board that conducted a self-assessment and identified disparities between the members’ experience and the company’s needs. Consequently, some directors resigned to make room for others with the desired experience.

322. The Sarbanes-Oxley requirement that companies’ audit committees disclose whether they have a financial expert will surely lead most to have such an expert. Lawrence Mitchell notes that while the expert doesn’t have greater legal liability, “the designation of a director as a financial expert will, as a psychological matter, impose upon that director a greater sense of responsibility for the corporation’s financial affairs than would be the case in the absence of such designation.” Lawrence A. Mitchell, *The Sarbanes-Oxley Act and the Reinvention of Corporate Governance?*, 48 VILL. L. REV. 1189, 1199 (2003).

323. Black et al., *supra* note 307, at 1074–76; see also Blair & Stout, *supra* note 12, at 1780. The out of pocket settlements made by directors in some of the scandal-ridden companies may augur a change. Although, it is fairly likely that the conditions that made such liability possible will be exceedingly rare, and its specter may continue to be quite remote. See Michael Klausner, Bernard S. Black & Brian R. Cheffins, *Outside Directors’ Liability: Have WorldCom and Enron Changed the Rules?*, 71 STANF. LAWYER 36 (2005), available at [http://www.law.stanford.edu/publications/lawyer/issues/71/sl71\\_klausner.pdf](http://www.law.stanford.edu/publications/lawyer/issues/71/sl71_klausner.pdf) (last visited Mar. 5, 2006) (“Until now, it was rare for an outside director to have to pay money out of his or her own pocket to settle a shareholder lawsuit. The recent multimillion-dollar payouts by former directors of WorldCom and Enron may have changed all that, but probably not by much.”). See also Ira Millstein & E. Norman Veasey, *Some Thoughts on Director Protection in Light of the WorldCom and Enron Settlements*, 44 THE METROPOLITAN CORPORATE COUNSEL (June 2005). Clearly, traditional incentives will now more directly motivate directors to carefully monitor, as will a climate in which monitoring is more expected. We can wonder how sizeable the effect will be, especially given that the out-of-pocket payments were a small portion of the compensation the directors received for their board service. But in any event, our main policy prescriptions—less emphasis on independence, more emphasis on developing and marshalling expertise—are unaffected.

324. Black et al., *supra* note 307.

consequences for lax monitoring. The relevant reputational community may be quite good at appraising director monitoring; moreover, reputation may not lend itself as well as law to being used strategically by the actors. Reputational considerations thus may motivate directors to try to “get it right” rather than creating a record they can point to in court as justifying their conduct. The increased reputational consequences of lax monitoring may therefore be able to do what law cannot: encourage enough residual distrust that the directors will notice red flags and be able to update their assessment of the officers’ trustworthiness generally, but not so much as to lead to a paralyzing “search for everything.”<sup>325</sup>

One important caveat is in order. Our analysis addresses specifically the types of difficulties that occurred in Enron and the other scandal-ridden companies. It is inapt for another important problem facing boards of directors: compensation. Executive compensation has increased precipitously in the recent past, and the connection between pay and performance is tenuous; even badly-performing CEOs are often generously rewarded.<sup>326</sup> In this context, overtrust is not the problem. The relevant inquiries are straightforward, and it takes little special expertise to scrutinize a pay package. Rather, the problem may very well be lack of independence, writ large, where even remote degrees of connection suffice to give directors a problematic interest in high compensation levels, and the existence of compensation consultants who recommend these levels gives the directors sufficient reputational (and legal) cover.<sup>327</sup> Recent trends—boards firing unsatisfactory CEOs but also awarding compensation at record levels often without a link to performance—suggest that the present level of independence may be increasingly effective at acting on evidence of misdeeds but is ineffective at addressing excessive compensation. There is some indication that “shaming” by institutional investors may be beginning to have an effect in limiting

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325. This analysis highlights an additional flaw associated with monitoring by boards of directors who are closely involved in management’s decision-making processes: the risk that monitors will fail to punish bad managers, even after managers’ decisions are revealed as flawed, for fear that their own reputations will suffer. Indeed, it is difficult to find acceptable ways to reduce these sorts of costs to monitors of punishing or even uncovering bad behavior. Financial mechanisms such as whistleblowing bonuses or encouraging monitors to take financial positions that increase in value if bad behavior is detected and revealed seem unpalatable at best and may have perverse incentives. Thus, we concentrate on reducing transaction costs of punishing and revealing such behavior and increasing the reputational (and perhaps legal) costs of not doing so. See O’Connor, *supra* note 265, at 1277–78.

326. See generally BEBCHUK & FRIED, *supra* note 289.

327. Indeed, some have argued that the only way to address this problem is shareholder-selected directors. See BEBCHUK & FRIED, *supra* note 289.

executive compensation and better anchoring it to performance.<sup>328</sup> Shareholder proposals to limit executive compensation and require majority votes for directors,<sup>329</sup> and greater disclosure of executive compensation,<sup>330</sup> are also increasingly being promoted. Our analysis argues in favor of giving these measures a chance to work rather than pushing for greater levels of board independence; greater independence, with its considerable costs, may not be necessary to get monitoring that is well situated to detect potential Enrons.

## V. CONCLUSION

Many legal scholars incorrectly assume that interpersonal trust is an unmitigated good (or bad) and that legal policy should therefore be crafted to maximize (or minimize) trust. A more nuanced understanding of trust indicates that trust should instead be optimized.

Where people can be expected to be able to process trust-relevant information relatively accurately, the role of the law is limited to providing a safety net to optimally encourage people to interact with strangers. The safety net should not, however, be too strong, lest people rely on law rather than acquiring appropriate levels of trust-relevant information. However, sometimes, people cannot be expected to be able to process trust-relevant information accurately. We identify types of relationships when this is apt to be the case. Undertrust is likely to exist when dealing with members of out-groups and in other cases where the risks of trust seem great. Overtrust can be expected where one party is dependent on the other in a relationship and/or where in-group membership is implicated. Trust biases can be magnified or perpetuated because some trust assessments are made subconsciously, and because trust feelings can create emotional reactions that trigger heuristic thought processes that work to strengthen confirmation biases. As a consequence, in some contexts, individuals cannot be expected to accurately process trust-relevant information about others. In those relationships, legal tools can be utilized either to help parties to more carefully calibrate their trust assessments or to mitigate the costs of inevitably suboptimal trust.

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328. See Claudia Deutsch, *My Big Fat CEO Paycheck*, N.Y. TIMES, Apr. 3, 2005, at 1.

329. See generally <http://www.corpgov.net/news/news.html> (last visited Nov. 20, 2006).

330. In July 2006, the SEC adopted changes to the rules requiring disclosure of executive and director compensation, related person transactions, director independence and other corporate governance matters, and security ownership of officers and directors. These changes would affect disclosure in proxy statements, annual reports and registration statements, as well as the current reporting of compensation arrangements. See <http://www.sec.gov/investor/pubs/excomp0803.htm>.



We identified two relationships where, if left unregulated, one of the individuals will likely inaccurately assess the trustworthiness of the other. In the corporate governance context, directors have been inclined to overtrust officers; we explored possible mechanisms for promoting specific types of distrust on the part of directors without excessively eroding their residual trust in the officers. In doctor-patient relationships, patients similarly overtrust doctors, albeit for different reasons. Patient trust is more resilient than director trust, so policymakers need not be as sensitive to eroding beneficial patient trust in fashioning healthcare regulations. Moreover, because patients often benefit from overtrusting their doctors, promoting more accurate patient trust assessments likely would prove costly. Health care law should (and does) instead focus on promoting doctor trustworthiness and compensating patients who suffer harm from misplacing their trust. Our analysis in both contexts is intended merely to provide examples of ways in which a cognitive trust framework can better inform policy questions. We leave for another day a more detailed exploration of trust-relevant regulation of these and other fields.