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Solving Creditor Problems in the Twilight Zone: Superfluous Law and Inadequate Private Solutions

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Abstract

Fiduciary duties are an integral part of the corporate law landscape. The law and economics analysis of such duties holds that these duties fill contractual gaps in a transaction cost saving way. Although duties to shareholders are well settled, duties to other participants as creditors or employees, i.e. stakeholders, are heavily debated. Although these participants also face the problem that the shareholders or the firm's directors may opportunistically expropriate their incomplete contract, it is far from settled that these groups need protection via a general duty. In this paper, I address the question whether a shareholder maximization duty should be complemented with a duty to creditors, especially when the firm is in the vicinity of insolvency, or with a duty to refrain from wrongful trading, or none at all. In the analysis, I compare these duties and discuss the efficiency consequences of these three within an agency theoretical framework. The upshot of the argument is that the efficiency of any subset of duties is influenced by ownership structure, generating different efficiency effects for different ownership structures. With respect to the publicly quoted large companies with dispersed owners a fiduciary duty or a wrongful trading rule seems superfluous at best. With ownership structures that fall between strongly concentrated and widely dispersed a wrongful trading rule partly mitigates part of the agency problems associated with shareholder dominated boards, while private solutions are inadequate. On balance a wrongful trading rule is slightly superior to a fiduciary duty to creditors, but might not be value relevant, i.e. be superfluous.

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