NOT-SO-ORDINARY JUDGES IN ORDINARY COURTS:
TEACHING JORDAN V. DUFF & PHELPS, INC.

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Everyone loves a brawl.

And all the more so when the brawlers are smart, biting, literate debaters who routinely take wildly out-of-fashion positions. For a casebook editor trying to maximize adoptions, that makes Jordan v. Duff & Phelps, Inc.1 an easy call.2

Jordan juxtaposes at-will employment with corporate fiduciary duties. The plaintiff, employee-shareholder James Jordan, argued that his employer, Duff & Phelps, should have told him about its secret merger negotiations when he quit and sold his stock to the firm. Writing for the Seventh Circuit majority, Judge Easterbrook agreed. Fellow panelist Judge Posner dissented.

Judge Easterbrook wrote that denying recovery, as Judge Posner would have done, would effectively tell Jordan that Duff & Phelps could have declared:

In a few weeks we will pull off a merger that would have made your stock 20 times more valuable. It’s a shame you so foolishly resigned. But even if you hadn’t resigned, we would have fired you, the better to engross the profits of the merger for ourselves. So long, sucker.3

Judge Posner gave as good as he got, saying of Judge Easterbrook’s logic:

This is the kind of legal half-truth that should make us thankful that our opinions are not subject to Rule 10b-5.4

To buttress his reasoning, Judge Easterbrook quoted Judge Posner’s classic treatise for the proposition that:

[T]he fundamental function of contract law . . . is to deter people from behaving opportunistically toward their contracting parties, in order to en-

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1 815 F.2d 429 (7th Cir. 1987).
3 Jordan, 815 F.2d at 437 (internal quotation marks omitted).
4 Id. at 448 (Posner, J., dissenting).
courage the optimal timing of economic activity and to make costly self-
protective measures unnecessary.

Judge Posner would have none of it:

The inroads that the majority opinion makes on freedom of contract
are not justified by its quotation from my academic writings . . . or
(my favorite one-liner in the entire corporate law casebook)
by the possibility that corporations will exploit their junior executives,
which may well be the least urgent problem facing our nation.

The third judge on the panel? Judge Cudahy seems to have
watched bemused from the sidelines. His colleagues "argue[d] lucidly
and cogently (and ingeniously) their respective points of view," he wrote. "The case [was] not easy," but he voted with Judge
Easterbrook.

I. THE CASE

Jordan worked as a securities analyst at Duff & Phelps's Chicago
headquarters. In taking the job, he signed no employment contract.
According to Duff & Phelps's policy, however, he could regularly in-
vest in the closely held firm's stock. By late 1983, he owned about a
one-percent stake.

When buying the stock, Jordan signed a shareholders' agreement.
Through it, he acknowledged that "nothing herein contained [would] confer on [him] any right to be continued in the employment of the Corporation." He agreed that if he left the firm for any reason, he would resell the stock for its book value at the end of his last calen-
dar year of employment.

Jordan's wife and mother, who also lived in Chicago, did not like
each other. To placate his wife, Jordan decided to look for work else-
where. In November 1983, he obtained an offer from Underwood Neuhaus in Houston. He took the job and tendered his resignation to
Duff & Phelps chairman Claire Hansen. Hansen accepted it, but let
Jordan work until the end of the year to obtain a higher book value
for his stock — a total of about $23,000.

On January 10, 1984, Duff & Phelps announced a merger with Sec-
urity Pacific at a price that would have let Jordan clear at least

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5 Id. at 438 (majority opinion) (alteration in original) (quoting RICHARD A. POSNER, ECO-
NOMIC ANALYSIS OF LAW 81 (3d ed. 1986)) (internal quotation marks omitted).
6 Id. at 449 (Posner, J., dissenting).
7 Id. at 443 (Cudahy, J., concurring).
8 Id.
9 Id. at 432 (majority opinion).
10 Id. at 446 (Posner, J., dissenting) (internal quotation marks omitted).
11 Id. at 432 (majority opinion).
12 See id.
$450,000, and possibly as much as $646,000, for his stock.13 What is more, the firm explained that Hansen had preliminarily tried to negotiate a merger the previous summer. Those initial talks had collapsed, but Hansen had renewed negotiations in December and finalized the deal’s price and structure.14

Jordan refused to cash his $23,000 check from Duff & Phelps. Instead, he sued. While the suit was pending, the merger collapsed (again), this time because the Federal Reserve placed on it conditions that were too onerous. In December 1985, however, Duff & Phelps’s senior managers decided to acquire the firm through an Employee Stock Ownership Trust in a leveraged buyout. Had he stayed at Duff & Phelps and sold his stock to the company, Jordan claimed, he could have cleared nearly $500,000.15

Jordan argued that Hansen violated the “disclose or abstain” rule at the heart of Rule 10b-516 by repurchasing Jordan’s stock on the firm’s behalf at book value without disclosing the summer merger talks.17 If Hansen had disclosed the talks, Jordan never would have resigned (or so he said). Instead, he would have stayed through 1985 and sold his stock for $500,000.18

The district court apparently thought this a simple case. Duff & Phelps was a closely held company, it noted, but Security Pacific was not. The law excepted both parties from the duty to disclose material information about pending merger talks when they repurchased stock if either party was publicly traded and the parties had yet to reach an agreement in principle on the merger’s terms.19 Here, the firms had not yet agreed when Jordan tendered his resignation to Hansen, and Security Pacific was public. Accordingly, the district judge reasoned, Hansen owed no duty to disclose his merger discussions to Jordan.20

Yet simple the case was not meant to be. Judge Easterbrook granted that publicly traded firms need not disclose pending merger talks before they agree “on the price and structure of the deal.”21 But closely held firms must disclose all material information even before they reach such an agreement, and even if they merge with a public

13 See id. at 433.
14 See id.
15 Id.
17 See Jordan, 815 F.2d at 445 (Posner, J., dissenting).
18 See id. at 433, 441 (majority opinion).
20 See id. at *3.
21 Jordan, 815 F.2d at 431.
As a result, the district court’s quick and dirty resolution simply got it wrong.

To reverse the lower court, Judge Easterbrook proceeded through several logical steps. First, the merger talks were material to Jordan. He had to decide whether to sell his stock to Hansen, and for that the possibility of a high-priced merger mattered. Second, although Jordan could not hold his stock if he quit, he did not need to quit. Instead, he could have chosen to stay at Duff & Phelps and keep his stock. Third, even though the Security Pacific deal eventually collapsed, Jordan might rationally have stayed at the firm in hopes that another buyer would eventually offer lucrative terms — as indeed one did. Last, although Jordan had no right to stay at Duff & Phelps, Duff & Phelps had shown no inclination to fire him. What is more, Duff & Phelps could not have fired him just to increase senior management’s gains in the buyout (what Judge Easterbrook called an “opportunistic” firing). It could not, as Judge Easterbrook inimitably put it, have told him that “even if you hadn’t resigned, we would have fired you, the better to engross the profits of the merger for ourselves. So long, sucker.”

Hence the decision: Jordan had the option of staying at Duff & Phelps and keeping his stock; in order to decide whether to exercise that option, he needed information that Hansen had but did not disclose; Hansen and Duff & Phelps stood in a fiduciary relation to Jordan as shareholder; and in repurchasing Jordan’s stock without disclosing the information Jordan needed to decide whether to keep his stock (and stay) or sell it (and go), Hansen and Duff & Phelps violated the disclose or abstain duty of Rule 10b-5.

Judge Posner focused on Judge Easterbrook’s last point. He began by noting that Jordan, as an employee at will, had no legally recognizable right to stay at Duff & Phelps. If he had no right to stay, he had no right to keep his stock. Although Rule 10b-5 mandates disclosure,
disclosure is necessary only when an investor can respond to any information he obtains. Without a right to hold stock as a Duff & Phelps employee, Jordan lacked a right to respond to any news of a merger.\footnote{See id. at 448.}

Second, although Duff & Phelps showed no inclination to fire Jordan, the law should not penalize firms for being nice. The firm could have fired him, and for any reason whatsoever. If it had, then Jordan could not have kept his stock — and could not have sold it at the higher buyout price.\footnote{See id. at 449–50.}

Last, even if corporate law imposes fiduciary duties to minority shareholders on directors, Judge Posner argued, Jordan waived any resulting rights. Through the shareholders’ agreement, he specifically agreed that “nothing herein” would “confer on [him] any right to be continued in the employment of the Corporation.”\footnote{Id. at 449 (internal quotation marks omitted).} He had a right to the information only if he had a right to stay at Duff & Phelps; as an at-will employee, he had such a right only if he obtained it as an adjunct to any right he might acquire as a minority shareholder; and through the shareholders’ agreement, he waived all such rights.\footnote{Id. at 446.}

But there was a potential catch. In the early 1980s, Hansen had had an affair with Carol Franchik. When fired, she had threatened suit. In response, the board adopted a resolution allowing anyone who had been fired to keep his or her stock. Suppose Jordan wanted to stay and refused to quit. To rid itself of him, the firm would have needed to fire him. Yet if it fired him, by the terms of the resolution he acquired a legal right to keep his stock. Would that not destroy Judge Posner’s argument? Apparently, the requirement that departing employees sell their stock stemmed from the shareholders’ agreement, and the agreement was subject to change only by unanimous shareholder vote. As a result, the “Franchik Resolution” was invalid on its face.\footnote{Id. at 434 (majority opinion).}

II. TEACHING JORDAN

So did Judge Posner get it right? More specifically, as a federal judge ruling on a state law issue, did he apply the rule a state court judge would have applied? To my mind, the answer is no, and shows the risk inherent in appointing judges too creative and independent for the job. Did he nonetheless take an approach that made sense? The

\footnote{See id. at 448.}
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\footnote{Id. at 446.}
\footnote{Id. at 434 (majority opinion).}
answer is yes, and illustrates the second-best principles that ought to determine the rules real-world courts apply.

Typically, I teach Jordan two-thirds of the way through the semester, after the well-known case of Wilkes v. Springside Nursing Home, Inc. By then, I find it hard to claim that Judge Posner applied anything close to the rule a typical state court judge would have applied.

In Wilkes, the Massachusetts Supreme Judicial Court faced a conflict among four 25% shareholders of a nursing home in Pittsfield, Massachusetts. According to the court, three of the shareholders violated their fiduciary duty to the fourth (Wilkes) when they fired him from his job as the home’s maintenance man. Shareholders traditionally owe no fiduciary duties to each other, the court explained, but partners do. Yet close corporations are much like partnerships. As a result, shareholders in close corporations should owe duties similar to those of partners. Although the four Wilkes shareholders deliberately chose the corporate form, under the opinion they incurred fiduciary duties close to those they would have owed had they chosen a partnership instead.

In effect, the Wilkes court faced investors who could have selected strict fiduciary duties but opted for laxer duties instead, and then imposed on them rigid and demanding duties anyway. It faced investors who deliberately tried to waive fiduciary duties, and refused to let them. This rule is not peculiar to Massachusetts. Both Indiana and Illinois courts have explicitly adopted the Wilkes formula as well.

As a result, if the Wilkes court had faced the Jordan facts, I find it hard to believe it would have dismissed Jordan’s claim. To be sure, Jordan worked under an at-will contract — but then so did Wilkes. Judge Posner would have let Hansen fire Jordan as stock analyst. The Wilkes court refused to let the ruling trio fire Wilkes as maintenance man.

Fundamentally, both Judge Easterbrook and Judge Posner explicitly treat corporate law (and its constituent fiduciary duties) as a waivable default contract. In part because of pioneering work by Judge Easterbrook and Professor Daniel Fischel, this approach has become

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36 Id. at 659–60.
37 Id. at 661.
38 Id.
39 Actually, the four were also directors as well as shareholders, id. at 660, and owed fiduciary duties in that capacity.
41 See, e.g., Nagy v. Riblet Prods. Corp., 79 F.3d 572, 576 (7th Cir. 1996) (Easterbrook, J.) ("[T]he corporate charter is a species of contract, and selecting a state of incorporation then is no different from putting a choice-of-law clause in a complex commercial contract.")
the law and economics orthodoxy. 42 Indeed, it constitutes the basis from which most modern corporate legal scholarship proceeds, and for good reason: it makes sense.

Yet this scholarly enthusiasm for the fiduciary-duties-as-default approach is not one that state court judges necessarily share. 43 As in Wilkes, state judges often treat fiduciary duties as sacrosanct and resist any attempt to loosen them. While on the New York state bench, Justice Cardozo famously immortalized that reverence in Meinhard v. Salmon 44 with his inimitable purple prose:

Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior [for fiduciaries] . . . . Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. . . . [This standard for fiduciaries] will not consciously be lowered by any judgment of this court.45

Although now nearly eighty years old, Meinhard embodies a reverence toward fiduciary duties that state judges routinely still display. From 2001 to 2005, judges cited Meinhard eighty times, the majority of those instances in state courts. Indeed, in another case arising out of the same Duff & Phelps sale, the Eleventh Circuit held it “a violation of fiduciary principles . . . to require employees to contract away their right to make a return on their investment.” 46 Hence the dilemma: state judges often reject the Easterbrook-Posner framework and apply instead a distinctly moralistic approach; Erie 47 requires Judges Easterbrook and Posner to apply state law; but they recoil at the idea of doing so.

Let me suggest the locus of the problem: judging is not a job for unconstrained, innovative minds. Judges are government bureaucrats. Their job is to be honest, to unravel a set of facts, to decide what law

43 Some scholars are more optimistic. Professor Stephen Bainbridge, for example, argues that courts do generally let people waive their fiduciary duties. See Stephen M. Bainbridge, Corporation Law and Economics 823–25 (2002).
44 164 N.E. 545 (N.Y. 1928).
45 Id. at 546 (citation omitted) (quoting Wendt v. Fischer, 154 N.E. 303, 304 (N.Y. 1926)). This point about Justice Cardozo does not say something that Judges Posner and Easterbrook do not recognize. Judge Posner himself describes Meinhard as the “most famous of Cardozo’s moralistic opinions” and implies that “the moralistic streak in Cardozo may have led him astray.” Richard A. Posner, Cardozo 104 (1990). “The characteristic analytic flaw” to Justice Cardozo’s opinions, Judge Posner aptly quips, “is the substitution of words for thought.” Id. at 119. For Judge Easterbrook’s perspective on Wilkes, see Easterbrook & Fischel, supra note 42, at 247–48.
47 Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).
applies, and not to think too hard about it all. 48 Despite our attempts to cow first-year students over the ambiguities involved, applying legal rules to facts is rarely rocket science.

Consider a parallel from the other legal system I know, that of Japan. By all accounts, Japanese judges are relentlessly honest, and among the smarter members of the bar. Yet they work within a judicial bureaucracy that rigidly rewards conformity — and conform they do. 49 Hired in their late twenties, Japanese judges are regularly evaluated by senior judges in the judicial personnel office. 50 Those senior judges then decide which judges to promote, which to stall, and when necessary (it rarely is), which to fire. 51 Judges who work hard, who clear their dockets quickly, and who do not make waves earn regular promotions. They climb the pay scale quickly and obtain postings in the most desirable cities. 52 The heterodox wallow in undesirable posts at low pay.

The result is an institution that does not work perfectly but that does facilitate dispute resolution more effectively than American courts do. 53 The courts do not attract or encourage creative minds, but that is the point. In the vast majority of real and potential disputes, the law that applies would be easy to predict if judges did not — and in Japan they do not — try hard to improve the world. And if parties could predict it, they could and would — and in Japan they can and do — settle their disputes out of court in the law’s shadow and pocket the fees they would otherwise pay their lawyers. If parties to contractual arrangements did not like the rule, they could and would — and in Japan they can and do — simply adjust the contractual terms and price accordingly ex ante.

Under *Erie*, the job of a federal judge applying state law is similarly mechanical: to mimic the state court. The federal judge is not to reinvent corporate law on a more sensible plane. Indeed, he is not to

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49 For empirical evidence of these claims, see Ramseyer & Rasmusen, *supra* note 48, at 122–68. True, the Japanese legal system is a “civil law system,” but the distinction is for present purposes a red herring.

50 See id. at 8–9.

51 See id. at 9–13.

52 See id. at 13–15.

reinvent any law at all. He is to apply it. If citizens want their world
to go to hell, Justice Oliver Wendell Holmes memorably remarked, a
judge’s job is to help them.54 If state courts want to send it there too,
a federal judge's job is to help them as well. Fundamentally, design-
better legal rules is not a judge’s job.

Judges may enjoy creating better rules, but judicial experimenta-
tion necessarily makes it harder for disputants to predict what judges
will do. An efficient legal system is one that disputants can avoid
through settlement. To do so, they need courts that operate rigidly and
mechanically — and judges who abandon any intellectual ambitions
and resign themselves to working as lower-level bureaucrats. For that
to happen reliably, judges need to suffer career penalties for deviating
from established rules. We lack ways to impose such penalties in the
United States. But appointing judges with the intelligence and crea-
tivity of Judges Easterbrook and Posner is — not to mince words —
exactly what we should not be doing. As judges, they simply do too
much: they muddy the law by trying to fix it, and they worsen the law
by encouraging (through example) their less talented peers to do so as
well.

On the second question — whether Judge Posner took an approach
that makes sense — I find it easy to sympathize. Again, consider the
Japanese parallel. Japanese judges routinely dismiss claims that
American judges would entertain.55 They recognize, in effect, that
real-world courts do not handle some disputes well. Rather than try to
right every wrong, they understand that for many wrongs in this
world, the courts cannot reasonably provide a remedy.

An approach, like this one, that recognizes the inherent limitations
of the court has much to say for it. Scholars generally prefer legal sys-
tems that try to fix every problem, of course. On that score, the Japa-
nese professoriate matches the American academy measure for meas-
ure. But the more limited approach has its roots in the basic
distinction between first- and second-best legal rules.

Legal scholars typically start by asking whether the plaintiff suf-
f ered a loss. They then ask — depending on the policy preferences of
the scholar — whether making the plaintiff bear the loss seems unfair,
whether the defendant has the resources to bear the risk more easily,
or whether judicial intervention would facilitate more efficient eco-
nomic decisions. If they answer yes to the question they ask, they rea-

54 Letter From Oliver Wendell Holmes, Jr., to Harold J. Laski (March 4, 1920), reprinted in 1
55 To be sure, they also entertain many suits that American courts rightly dismiss. Landlord-
tenant and employment claims are perhaps the most disastrous examples. For an overview of
landlord-tenant law in Japan, see J. MARK RAMSEYER & MINORU NAKAZATO, JAPANESE
son that a court should entertain the case. The disasters resulting from
the first two approaches are of course the stuff on which the young
Professor Posner made his name.

After forty years of law and economics, we now opt routinely for
the third approach instead. In torts, for example, the plaintiff should
collect if, but only if, the defendant could have avoided the loss more
cheaply than the plaintiff. In contracts, courts imply a term if, but
only if, as Judge Easterbrook put it in Jordan, “the parties would have
bargained for [it] if they had signed a written agreement.”

Unfortunately, this law and economics formula rests on a first-best
approach. Suppose, however, that lawyers are expensive and often
dishonest; that courts are slow and cumbersome; that judges (decidedly
not the panel in Jordan) are only modestly intelligent, frequently
wrong, badly harried, and in the pockets of the lawyers who funded
their reelection campaigns; or that juries only randomly determine the
facts correctly. Suppose, in short, that we live in the world that we do.
If so, then the right legal rule may not be the one that places the loss
on the cheapest cost avoider. It may be the one that forthrightly dis-
misses the claim.

In a second-best world, the right legal rule is not one that tries to
get the right result every time. It is the rule Professor Richard Ep-
stein attributes, in casual conversation, to the late Professor Walter
Blum: a simple, easily implementable rule that gets the right result
95% of the time. In fact, even that approach may overestimate the
abilities of real-world courts. In our badly flawed legal system, per-
haps the right legal rule is not one that tries to get the right result 95%
of the time. Perhaps it is a rule that leaves courts satisfied with a de-
cent result 60% or 70% of the time. In either case, the easiest such
rule to implement is the one Judge Posner adopted in Jordan: tell the
plaintiff to get lost.

Because Jordan waived any right based on the shareholders’
agreement to stay at Duff & Phelps, Judge Easterbrook relied heavily
on what he saw as the limitations on Duff & Phelps’s ability to fire
him. In particular, he reasoned that the firm should not be allowed to
fire him for opportunistic reasons — to prevent his obtaining the
higher market price for his stock. Necessarily, this approach takes

56 Jordan, 815 F.2d at 438.
57 See, e.g., Stephen M. Bainbridge & G. Mitu Gulati, How Do Judges Maximize? (The Same
Way Everybody Else Does — Boundedly): Rules of Thumb in Securities Fraud Opinions, 51
the judicial process involved no transaction costs, of course, a rule that plaintiffs always win a
given type of case would be every bit as efficient as a rule that plaintiffs always lose. Real-world
judicial processes, however, are never free.
courts into the business of asking why firms fire their at-will employees and whether those reasons are “opportunistic.” Ex ante, Judge Easterbrook’s rule plausibly encourages parties to avoid devious strategies and behave honestly. Presumably, such is what most (or virtually all) parties would want of their partners, whether or not they drafted a contract. In a first-best world, the rule makes eminently good sense.

But we do not live in a first-best world, or anything close to it. In our world, perhaps the right approach is to ask whether Jordan negotiated a contractual right to keep his job. If he did not — if he accepted an at-will contract — then he had no right to continued employment. Given that he could have kept his stock only if he kept his job, he had no right to hold his stock either. And if he had no right to hold his stock, he had no claim to assert. End of story. If firms and employees dislike the result, they can write a contract to the contrary at the outset.

Such is the opinion Judge Posner wrote. Harsh, perhaps; it made no attempt either to encourage “fair” deals (as earlier generations urged) or to discourage “opportunistic” behavior (as Judge Easterbrook urged). Given our imperfect legal system, however, perhaps those are precisely the aims to which we should not aspire.

III. CONCLUSION

By juxtaposing at-will employment with corporate fiduciary duties, *Jordan* creates something of a classroom brain twister. Yet the exchange between Judges Easterbrook and Posner also illustrates two fundamental but seldom recognized principles of real-world courts. First, the bench is properly a place for honest jurists of moderate talent who are, ideally, monitored for their work. It is not a place for men and women with the independence and sophistication of these two men. Such judges can muddy the law by trying to fix bad precedent, and worsen the law by setting interventionist examples for their far less talented peers.

Second, by basic second-best principles, the right legal rule for a substantial fraction of contractual disputes is not a rule designed to facilitate efficient deals. It is a rule that dismisses a plaintiff’s claim forthwith. We live in a world with imperfect judges, costly and dishonest attorneys, and only moderately intelligent juries. As Judge Posner implicitly recognized in *Jordan*, but other judges rarely do, many cases are simply beyond the capacity of most real-world courts to handle cost-effectively.