CELIA R. TAYLOR*

The Inadequacy of Fiduciary Duty Doctrine: Why Corporate Managers Have Little to Fear and What Might Be Done About It

> I certainly knew [my behavior] was nefarious, a little wormy, unethical, make no mistake about that. . . . [B]ut I was certainly willing to take the risk.
>
> —Jay Jones[1]

In the wake of recent and ongoing financial scandals, legislators and regulators rushed to address corporate malfeasance, most notably through rapid enactment of the Sarbanes-Oxley Act of 2002.[2] The result of these actions is yet to be determined. What *is* clear is that the laws on the books at the time of the Enron and WorldCom debacles proved ineffective to prevent disaster. How could corporate law fail to provide sufficient deterrence? How did so many get away with so much for so long? Why did corporate directors feel they had little to fear?

One contributing explanation can be found by examining the

* Associate Professor of Law, Strum College of Law at the University of Denver. B.A., George Washington University, 1986; J.D., New York University School of Law, 1989; LL.M., Columbia Law School, 2004. Many thanks to all those kind enough to review drafts of this Article and provide comments.

[1] Bruce Porter, *A Long Way Down*, N.Y. TIMES, June 6, 2004, § 6 (Magazine), at 52 (quoting Jay Jones).

[2] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C. and 18 U.S.C.); Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002, 67 Fed. Reg. 66,208 (Oct. 30, 2002) (to be codified at 17 C.F.R. pts. 210, 228, 229, 240, 249, 270, and 274); Improper Influence on Conduct of Audits, 67 Fed. Reg. 65,325 (Oct. 24, 2002) (to be codified at 17 C.F.R. pt. 240); *see also* NYSE Group, Inc., Final NYSE Corporate Governance Rules (2003), *available at* http://www.nyse.com/pdfs/finalcorpgovrules.pdf (publishing the Section 303A Final Rules).

history of corporate law and its treatment of corporations and corporate managers, specifically by looking at the interplay between strict regulation, permissive laws, and traditional fiduciary duty doctrine. This examination reveals a historical shift away from rigid regulatory control over corporate behavior to an extremely permissive regulatory regime. This shift occurred in response to both changing economic conditions and evolving theoretical conceptualizations of the corporate form. The combined impact of these practical and theoretical changes in the corporate arena eventually gave rise to a situation where American corporations, led by their officers and directors, act with little direct external regulation.

Further consideration of this devolution in the treatment of corporations and corporate management from strict regulatory control to permissive regimes shows that, whether consciously or not, regulators seemed willing to permit more flexibility in statutory corporate regulations as long as the common law required corporate behavior to be controlled by strict fiduciary duties. By the regulators' logic, if stringent fiduciary duties, specifically duties of loyalty and care, would be imposed by common law and enforced by courts, statutory control could take a backseat. As we shall see, corporate evolution continued to follow this path for some time.

Regulation governing corporate behavior gradually decreased its reliance on what was considered to be a demanding regime of fiduciary duty. Regrettably, fiduciary duty doctrine followed a similar path. While the duties of loyalty and care may once have operated to impose some real constraint on corporate management, over time their viability has largely been erased. So what happens when the control over corporate managers intended to be exercised by fiduciary duty doctrine disappears or is at least seriously undermined? The corporate malfeasance being revealed every day suggests a serious breakdown.

This Article begins from the premise that reliance on fiduciary duty doctrine to control corporate managerial behavior, as that doctrine is currently interpreted and applied, does not and cannot work. Under the current state of the law, corporate managers have little reason to fear that courts will find them liable for breach of fiduciary duty. They can act with virtual impunity, confident that they can flaunt the notion of fiduciary duty and courts will not often challenge directorial loyalty nor second-guess their

managerial decisions. This confidence helps to explain the misdeeds of corporate managers such as Kenneth Lay, Bernie Ebbers, and Dennis Kozlowski.

This Article explains the current state of corporate responsibility by focusing on what has been largely disregarded in academic discourse to date: the interconnectedness of regulatory regimes and fiduciary duty doctrine. Part I begins by examining the history and evolution of regulatory control over the corporate form. In doing so, it shows the gradual loosening of control over corporations as those entities gained prominence in the United States economy. This section also explains how the development of the corporation as an entity and the rapid growth of its use caused theoreticians to alter their conceptualization of what a corporation is. This discussion shows how these changing conceptualizations of the corporate form worked hand-in-hand with changes in the practical nature of the firm to explain and justify an extreme loosening of regulatory control. Part I also shows that this loosening was accepted because of the belief that common law fiduciary duty doctrine would provide sufficient monitoring of managerial behavior.

Part II of this Article outlines the devolution of those corporate fiduciary duties that were supposed to safeguard the corporate arena. It explores the historic bases of the traditional fiduciary duties of loyalty and care and examines how far the doctrine has moved from these historic baselines over time. This perspective shows that the effectiveness of traditional fiduciary duties as a control mechanism over corporate management has diminished greatly over time to the point where they now are of little effect.

The Article concludes that the loosening of regulatory control over corporate management, in the mistaken belief that fiduciary duty would provide sufficient disciplining incentive, helped create a culture where the current corporate scandals could flourish. It then suggests that a renewed emphasis on fiduciary duty is necessary to rebuild trust in the corporate arena and help forestall further bad action. In particular, the newly articulated duty of good faith shows promise. If this duty is carefully defined and consistently applied, perhaps fiduciary duty could play its intended role and prove effective in exercising some meaningful constraint on corporate managerial behavior.[3]

[3] The Delaware Supreme Court has announced that there is no independent duty

I

THE EVOLUTION OF ENABLING CORPORATE REGULATION

The nature and role of corporations in the United States economy have changed dramatically over time. In tandem with these changes in the practical functioning of corporations, theoretical conceptualizations of what constitutes a corporation have also changed greatly.[4] These changes, in turn, led to changing views on how business entities and their managers should be regulated.

In their earliest form, corporations were not the business entities we think of today, but instead took the form of municipalities, universities, and guilds created by English royal charter.[5] When the corporate form was instituted in America, a similar approach was used. Under early American law, corporations could exist only pursuant to a charter granted by a legislature upon special application.[6] Each special charter stipulated the obligations and privileges of the particular corporation, specifying for instance its permitted behaviors and required capital.[7] This system prevailed because of the then-dominant conceptualization of the corporation as an artificial entity owing its very existence to the willingness of the state to grant its being. As a strictly state-created entity, a corporation was considered properly subject to regulation and control by its creator. This understanding of a corporate being gave rise to the concession theory of corporate regulation.[8] This theory held that since corporations existed only at the will of the sovereign, a corporate entity possessed

of good faith, holding that "a failure to act in good faith is not conduct that results, *ipso facto*, in the direct imposition of fiduciary liability." Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369 (Del. 2006). Good faith remains an important concern, however, as a "failure to act in good faith may result in liability because the requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition 'of the fundamental duty of loyalty.'" *Id.* at 369-70 (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

4 *See, e.g.*, JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA 82-86 (2003); William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471 (1989).

5 *See* Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 GA. L. REV. 873, 874 (2000).

6 *See* JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780–1970, at 132 (1970) ("With no substantial exception, to 1800 and for some years beyond legislatures provided incorporation only by special charters . . . .").

7 *See id.* at 133-35.

8 *See* Bratton, *supra* note 4, at 1475. R

only those rights and privileges specifically granted to it by that sovereign.[9]

This conceptualization of the corporation clearly gave strong regulatory control to states through their exclusive and individualized charter authority. State legislatures, carrying on the work of the colonial assemblies, issued special charters conferring limited rights to corporations.[10] These rights, which typically included, among others, limited liability and the right to pool capital, were understood to be the only rights possessed by corporations receiving a special charter.[11] One of the earliest judicial pronouncements of the artificial entity and concession theories came in the famous case *Trustees of Dartmouth College v. Woodward*,[12] where the Court stated that a "corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it . . . ."[13]

The theoretical conceptualization of corporations and the regulatory regime governing their behavior began to change in the nineteenth century. With the growth of the American economy and increasing industrialization, corporations and the activities they engaged in became increasingly large and complex. Led by banking and transportation concerns, more and more businesses sought corporate charters[14] because of the important benefits the corporate form conferred. As corporations, businesses gained legal personality, the ability to centralize management, the power to issue transferable shares, and the right to limit the liability of individuals participating in the enterprise.[15] These important advantages gave businesses an increased desire to operate in the corporate form as the scale of their operations grew.

---

[9] *Id.*

[10] *See* HURST, *supra* note 6, at 132. **R**

[11] *Id.*

[12] 17 U.S. (4 Wheat.) 518 (1819).

[13] *Id.* at 636.

[14] LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 189 (2d ed. 1985) ("In Pennsylvania, 2,333 special charters were granted to business corporations between 1790 and 1860. Of these about 1,500 were transportation companies; less than two hundred were for manufacturing.").

[15] For an interesting argument that these reasons did not drive incorporation, but rather that entities with overseas operations seeking monopoly rights or protection comparable to those granted to municipalities spurred the effort, see Mahoney, *supra* note 5, at 886-87. **R**

The growing demand for special charters taxed the process of receiving such charters from state authorities on an individual basis but did not lead to its immediate decline, in part due to the fact that corporations were generally observed with deep-seated distrust. Given their genesis in monopolist enterprises and the special status conferred upon them by the state, corporations were viewed by many as parasitic and possessing power and privilege not available to others.[16] In theory, corporate reliance on special charters afforded states a mechanism of regulatory control over corporations: if an entity would not accept the terms of its charter it could not gain the advantages of the corporate form.

Maintaining control over corporations through the special chartering system included, by definition, maintaining control over their managers. Under this system, managers could act only in furtherance of the express purpose stated in the charter received by their respective corporations. This purpose, as noted, was quite limited. The desire to maintain strong control over corporations and their managers initially fostered reluctance to loosen the chartering system, despite its limitations.[17]

Eventually, however, the strong direct external regulation of corporations and their managers made possible by the special charter system fell victim to the demands of business. As the American economy grew and entities seeking the corporate form proliferated, legislatures could not keep up with the demand for special charters, and the inefficiency of the system became apparent.[18] The special charter system also came under attack due to a perception that such charters conferred unfair privileges on only a few.[19] In response to the apparent failure of the charter system, states began to turn to general incorporation laws.[20]

These laws replaced individually granted special charters with a system that enabled any entity that complied with a standardized set of requirements to gain a charter.[21] Thus, while corporations still depended on license from a state to come into being,

---

16 *See* FRIEDMAN, *supra* note 14, at 194. **R**

17 HURST, *supra* note 6, at 15-16.

18 *See, e.g.*, Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 49 AM. U. L. REV. 81 (1999).

19 *See* ARTHUR M. SCHLESINGER, JR., THE AGE OF JACKSON 188-89 (1945) (arguing that elimination of special charters and opening the availability of the corporate form to all would reduce special favors and promote competition).

20 *Id.*

21 FRIEDMAN, *supra* note 14, at 191-201. **R**

the process became pro forma, done without individualized attention and therefore without individually crafted regulatory control over the process. Starting with New York in 1811,[22] the trend of moving toward general incorporation statutes was so popular that by 1859, twenty-four of the thirty-eight existing states and territories operated under such a regime.[23] By 1875, virtually all states allowed entities engaging in private business to obtain a general charter.[24]

The switch to general charters loosened, but by no means removed, regulatory control over corporations. States continued to exert their will over corporate actions, typically by using standard pattern incorporation statutes that required, among other things, that corporations seeking charters be limited in size and comply with limitations on their stated purpose.[25] Thus, a glass manufacturer could manufacture only glass, a rubber manufacturer only rubber, and so forth. Any activities outside the express purpose stated in the charter were ultra vires.[26] Other common constraints imposed on corporations by early general incorporation statutes included limitations on capitalization, the types of shares a corporation could offer, and voting rights.[27] The rise of general incorporation statues caused a shift in how corporations were regulated on a practical level, with a concurrent decline in direct state control. The change also mandated a shift in theories of the corporate form. With more and more entities operating as corporations, the idea that a corporation was an artificial entity brought into being by state action did not comport with reality. Therefore, around the mid- to late nineteenth century, the aggregate theory of the firm developed, replacing the artificial entity and concession conceptualizations.[28] This aggregation theory drew on contemporary understandings of partnership law and viewed the corporation as an aggregation of those private parties

---

[22] Act of Mar. 22, 1811, ch. 67, § 1, 1811 N.Y. Laws 111 (authorizing general incorporation for entities engaged in the manufacture of "woollen, cotton or linen goods").

[23] *See* Hamill, *supra* note 18, at 103. **R**

[24] *Id.* at 106; *see, e.g.*, DEL. CONST. art. IX, § 1.

[25] *See* HURST, *supra* note 6, at 25-30. **R**

[26] *See* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 209.

[27] *See* HURST, *supra* note 6, at 21, 29, 45, 56, 69; Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 176 (1985). **R**

[28] *See* Horwitz, *supra* note 27, at 184-85, 203. **R**

who contracted to form the entity.[29] In its early inception, the aggregate theory of the firm considered shareholders as "the corporate aggregate's main, if not only, elements."[30] The state's role in regulating these entities was less significant, as shareholders could monitor corporate behavior effectively since they, in effect, *were* the corporation.

This aggregation conceptualization of the corporate form was short-lived because changes in the operations of corporations also demanded changes in understandings of the corporate nature and adjustment of the regulatory approaches controlling their behavior. The continued increase in the scale and scope of American business from approximately 1875 to 1930 caused states to move from using set-pattern general incorporation statutes to enabling incorporation statutes.[31] Entities formed under enabling statutes could structure their affairs relatively freely through careful drafting of their articles and bylaws; that is, states were no longer imposing stringent conditions on access to the corporate form.[32]

The increasing commonality of large firms dedicated to multiple purposes[33] forced theorists to reconsider issues of management and control. The artificial-entity conceptualization, drawing on partnership analogies, could not hold as shareholders clearly were not exercising control but were instead ceding that duty to corporate managers in most cases.

Again, the changing nature of the corporate form forced us to rethink the nature of the firm, and the real entity theory quickly replaced the belief that a corporation was an artificial creature. At its heart, real entity theory holds that a corporation has identity and attributes independent from its shareholders. The real entity theory, unlike the concession theory, states that corporations, like individuals, exist on their own and do not require state

[29] Brett W. King, *The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection*, 21 DEL. J. CORP. L. 895, 904 (1996).

[30] Michael J. Phillips, *Reappraising the Real Entity Theory of the Corporation*, 21 FLA. ST. U.L. REV. 1061, 1066 (1994).

[31] Reza Dibadj, *Delayering Corporate Law*, 34 HOFSTRA L. REV. 469, 494 (2005).

[32] *See* HURST, *supra* note 6, at 70 ("[N]ew statutes provided a standard corporate structure but allowed it to be varied within a range of increasing generosity by such departures as draftsmen might put into the corporation's articles or bylaws . . . ."). **R**

[33] *See* Bratton, *supra* note 4, at 1487. Bratton calls these entities "management corporations." *Id.* He characterizes them as large corporations in the business of both marketing and producing rather than one or the other as had been the rule. *Id.* **R**

recognition to come into being.[34]

This shift to conceptualizing a corporation as a real entity did not immediately signal the end of a belief that state regulation over corporations was necessary and appropriate. Just as an individual was properly subject to the sovereign state, so too were corporations, since according to real entity theory, a corporation was the functional equivalent of an individual.[35] Instead of immediate removal of state regulatory control, a more subtle change occurred with the advent of the real entity theory. Recall that when corporations were viewed as artificial entities, enmity toward them ran high. State regulation was vigorous due to the prevailing view that corporations were worthy of suspicion and distrust. In strong contrast, the flourishing of the real entity theory came at a time when corporations were considered essential to promoting business. Therefore, rather than advocating the curtailment of corporate behavior by strict regulation, common wisdom of the time held that corporate law should "enable businessmen to act, not . . . police their action."[36] This desire led to regulation being kept to a minimum.[37]

Following the real entity conceptualization of the corporation and the attendant universal adoption of enabling general incorporation statutes by the 1930s, theoretical thinking about the corporate form and the proper location of regulatory authority entered a dormant phase. The reason for this dormancy is unclear, although some allege that "intellectual fashions" simply changed.[38] Rule makers, with a renewed belief in the social utility of corporations, instead of looking to the nature of the corporate form as driving regulatory choices, took an approach that focused on instrumentalism. What mattered was enabling corporations to engage in business affairs—a departure from worrying

[34] *See, e.g.*, W. Jethro Brown, *The Personality of the Corporation and the State*, 21 LAW Q. REV. 365, 376-78 (1905) (contending that corporations compel states to grant them legal recognition); Harold J. Laski, *The Personality of Associations*, 29 HARV. L. REV. 404, 424-26 (1916) (arguing that corporations exist independent of state recognition).

[35] *See* Mark M. Hager, *Bodies Politic: The Progressive History of Organizational "Real Entity" Theory*, 50 U. PITT. L. REV. 575, 580 (1989) ("The real entity paradigm implied that corporations owe their existence and legitimacy to the distinct and unified purposes and wills of groups. . . . [T]he existence of a corporate entity was deemed to be as real as the existence of its members.").

[36] HURST, *supra* note 6, at 70 (citing A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931)). R

[37] *Id.* at 75.

[38] Phillips, *supra* note 30, at 1070. R

about what corporations "were" or how to control them. Regulation was kept minimal so that entrepreneurs could operate freely. So rampant was the liberalization of statutory restraints that one commentator stated: "We have nothing left but our great empty corporation statutes—towering skyscrapers of rusted girders, internally welded together and containing nothing but wind."[39]

Although rumblings of discontent began to surface among academics in the 1970s, the instrumentalist, antitheoretical approach toward corporate law held sway roughly from the early 1930s to the 1980s.[40] During this time, the belief that management needed to be free from regulation in order to run its enterprises properly "enjoyed such widespread acceptance that it preempted most deeper inquiry into the nature of the firm in legal theory."[41] Gone were efforts to justify regimes of corporate regulation based on a theory of the firm.[42] Managers were given great leeway to steer their enterprises as they saw fit.[43]

Despite some "anti-managerialist" voices in the 1970s[44] advocating for stronger external regulation of corporate managers, real change in conceptualizations of the firm and theories of reg-

---

[39] Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962).

[40] *See* Bratton, *supra* note 4, at 1508; Phillips, *supra* note 30, at 1070. **R**

[41] William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 413 (1989).

[42] *See* Bratton, *supra* note 4, at 1508 ("Theory of the firm had a bad reputation after the realist/anti-realist debate terminated in the late 1920s. . . . By 1976, traditional theory of the firm concepts had fallen so far from view that theoretically ambitious works on corporate structure omitted any mention of them."). **R**

[43] Of course, managerial power was not completely unchecked by regulation during this time. Several sources imposed requirements on corporate management. These included the listing standards of the various stock exchanges, the Securities Act of 1933, and the 1934 Securities and Exchange Act. The main thrust of these regulations was to require disclosure. They were generated by a concern for maintaining the integrity of the market rather than by a thoughtful analysis of the relationship between a theory of the firm and an appropriate regulatory model. It is also noteworthy that, for the most part, states were not the source of these regulations; instead, these directives stemmed from the federal government or a national organization.

The emphasis on mandatory disclosure is in keeping with the virtual elimination of other external regulation. The theory is that if shareholders receive adequate information, they can protect themselves against abuses perpetrated by unscrupulous managers, and thus "there is no need for the government to engage in more substantive securities regulation—merit review in the parlance." Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 418 (2003).

[44] *See* Bratton, *supra* note 4, at 1476. **R**

ulation did not take hold until the 1980s. At that time, the "nexus of contract" or "contractarian" model of the corporation gained prominence.[45] Drawing on work by Armen A. Alchian, Harold Demsetz,[46] Michael C. Jensen, and William H. Meckling,[47] among others, this theory of the firm fundamentally changes how a corporation is conceptualized by erasing the historic focus on management and its job in maximizing shareholder wealth. Instead, contractarians posit that a firm "is a complex set of explicit and implicit contracts."[48] Under this view, the modern publicly held corporation is a set of contractual relationships among the many participants in the corporate enterprise. While there is disagreement over how to determine participant status, the group generally is understood to include, among others, shareholders, creditors, and suppliers.[49] Each participant in a corporate venture assumes only those rights and obligations afforded it by contract. The terms of each contract include provisions of state law only to the extent that the parties to the contract so desire. State law requirements "are regarded as a standard form that can be accepted by the parties or rejected either by drafting around the provision or by incorporating in another state."[50] Because each participant in a corporate contract enters knowingly and willingly, no external monitoring or interference is necessary or desired.[51]

Under the contractarian conceptualization, management theoretically has no special place or power but is simply one of many bargaining units.[52] Under this view, external regulation over management is not enormously important. It can (and should)

---

45 The prominence of the contractarian model is subject to some debate. While contractarian discourse seems to dominate the academic discussion, it is unclear whether courts, or corporate managers themselves, have abandoned the managerialist view that empowers managers to act freely on behalf of their shareholders.

46 Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

47 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

48 Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1418 (1989).

49 *See* Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 283 & n.1 (1998).

50 Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 7 (1990).

51 *See, e.g.*, Lawrence E. Mitchell, *Private Law, Public Interest?: The ALI* Principles of Corporate Governance, 61 GEO. WASH. L. REV. 871 (1993).

52 *See generally* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 369-72 (3d ed. 1986) (describing the corporation as a standard contract).

nevertheless provide necessary default rules so that parties need not negotiate certain basic points every time they contract.[53] Beyond that, however, regulation should not put impediments on the free negotiation of contractual arrangements.[54]

Discipline of corporate management then comes not from externally imposed rules of conduct but from the policing feature of the market. In an efficient market (and the contractarians assert that the market for corporate management is efficient), "a corporate shareholder gets what he is paying for in both the terms of the contract and the substantive nature of the product, *including the quality of management*."[55] Thus under the contractarian view, not only should corporate managers be free from external constraints other than those imposed by market forces, but corporations, being themselves only a legal construct, should be similarly unfettered. And so we see at this point, in the evolution of ways to conceptualize the corporation and the relationship of such conceptualizations to regulatory schemes, a 180-degree turn from our starting point. No longer are corporations thought of as creatures of the state, properly and necessarily subject to its strict control. Instead, they are seen as semiorganic entities of their own right, subject to control by their contractual components as tempered by market forces.[56]

This conceptualization of the corporate form and its attendant impact on regulatory choices leaves a vacuum in some areas of corporate governance. Markets are generally understood to be amoral, concerned with the efficient allocation of resources. Efficient behavior is correct behavior, full stop. For those less enamored of the contractarian view, this amoral approach toward corporate law sits less comfortably. To justify the loosening of external regulation over corporations and their managers, many relied on the belief that a vibrant regime of fiduciary duties would provide sufficient safeguards. As stated by one noted jurist: "The most remarkable feature of U.S. corporation law generally, and Delaware particularly, is the great importance that it gives to the fiduciary duty concept and the resulting power of

[53] *See* Anthony T. Kronman, *Contract Law and the State of Nature*, 1 J.L. ECON. & ORG. 1, 28 (1985).

[54] *Id.*

[55] Butler & Ribstein, *supra* note 50, at 33 (emphasis added). **R**

[56] *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) (discussing the ability to draft around default rules).

courts to apply ex post evaluations of many important types of transactions."[57] If the fiduciary duty doctrine truly did perform this role, reliance on it as the watchdog of the corporate arena might be justified. Unfortunately, as the following discussion shows, the doctrine devolved over time and no longer performs its appointed task.

II

Nonregulatory Control over Corporate Behavior: Fiduciary Duty Doctrine

The preceding section outlined the changing roles of the firm in the United States economy, the changing conceptualizations of the corporation, and the impact these changes had on justifications for differing corporate regulatory models. As shown, the prevailing trend in corporate regulation over time has been toward a great loosening of regulatory control. This trend is not surprising. The growth in number and power of corporations in the American and global economies has all but dictated this result. This is not to suggest, however, that everyone was willing to simply give managers free rein. In fact, the process of liberalizing regulatory control over corporate affairs did not pass unnoticed or unexplained. Courts and commentators justified this loosening by pointing to the presence of nonstatutory restraints on corporate management and claiming that such restraints made statutory regulation unnecessary.[58] Specifically, corporate fiduciary duties were said to provide any necessary protection lost by the loosening of other regulation.[59] Common law would provide what statutes did not: managers could move freely in the corporate universe, but their movements would be held in check, not

[57] William T. Allen, Prof. of Law & Business, New York Univ., The Pride and Hope of Delaware Corporate Law, Keynote Address at the Widener Univ. Sch. of Law Symposium: The Next Century of Corporate Law (May 20, 1999), *in* 25 Del. J. Corp. L. 70, 72 (2000).

[58] William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 Del. J. Corp. L. 859, 862-63 (2001); Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 Del. J. Corp. L. 499, 501 (2002) ("Delaware's enabling statute is premised on its use within a system of corporate law that uses . . . fiduciary duties as an additional restraint on director action. This fiduciary restraint enables stockholders to benefit safely from the flexibility of the DGCL's enabling approach because the common law limits the ability of directors to abuse that flexibility for their own self-interest at the stockholders' expense.").

[59] *See* Allen et al., *supra* note 58, at 862-63; Strine, *supra* note 58, at 501. R

by substantive regulation, but by certain minimum standards imposed by fiduciary duties.[60]

Corporate fiduciary duties have long been considered vital in controlling corporate management. Early conceptualization of corporations as glorified partnerships naturally led to directors and officers being considered subject to duties comparable to those held by partners.[61] These duties demanded selfless behavior from corporate management.[62] If these duties worked as idealized, the excesses of corporate malfeasance so common today would, in theory, be impossible.

So what happened to fiduciary duties as conceptualizations of the corporation changed over time? The following section provides an overview of the common law development of fiduciary duties in the corporate context and suggests, as Grant Gilmore did with the law of contract, that the "modernization" of corporate theory is causing the death of fiduciary duty.[63] Like Gilmore's argument in regard to contracts, I suggest that examination of the "evolution" of corporate fiduciary duty is in fact "a study in . . . the process of doctrinal disintegration."[64] Understanding this process of disintegration and its relation to the loosening of regulatory control over corporate behavior greatly aids our understanding of the current crisis facing corporate theoreticians and practitioners.

A. The Historic Baseline of Corporate Fiduciary Duty

The belief that certain individuals are subject to fiduciary duties is a long-standing one with its roots in equity. The doctrine was first expressed through decisions of the English Court of Chancery.[65] That court was charged with upholding the "conscience of the King as seen through the moral considerations of the dictates of the church."[66] Thus, the Chancellor was not bound by rigid dictates of "law" but could fashion remedies, taking into consideration moral principles and current societal val-

---

[60] *See* Allen et al., *supra* note 58, at 862-63; Strine, *supra* note 58, at 501. **R**
[61] *See* FRIEDMAN, *supra* note 14, at 515-17; HURST, *supra* note 6, at 78, 98-99. **R**
[62] FRIEDMAN, *supra* note 14, at 515-17; HURST, *supra* note 6, at 78, 98-99. **R**
[63] *See generally* GRANT GILMORE, THE DEATH OF CONTRACT (1974).
[64] *Id.* at 101.
[65] L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 70.
[66] Cecil J. Hunt II, *The Price of Trust: An Examination of Fiduciary Duty and the Lender-Borrower Relationship*, 29 WAKE FOREST L. REV. 719, 728 (1994) (citing FLEMING JAMES, JR. & GEOFFERY C. HAZARD, JR., CIVIL PROCEDURE § 1.6 (3d ed. 1985)).

ues.[67] These ideas led to flexible, fact-specific outcomes when breach of trust or confidence was charged. These notions also demanded that the court pay heed to issues of morality and ethics in determining whether fiduciaries lived up to their tasks.[68] Drawing on these roots, a fiduciary relationship, as the idea is used today, implies that forces beyond positive law are at play and that justice and social values must be considered when determining appropriate behavior.[69] Therefore, common law fiduciary duties stand apart from regulation, controlling behavior not by sanctioning specific behavior per se, but by demanding that fiduciaries comport with standards of behavior that society deems to be required by the fiduciary position.

In the corporate context, the existence of fiduciary duties is well settled. Although corporate fiduciary duties elude precise definition[70] (in part because of the fluid notion of equity), it is generally accepted that corporate officers and directors[71] are subject to duties of care and loyalty.[72] At heart, each of these duties incorporates the belief that officers and directors owe first allegiance to their corporation and its shareholders and, with this, must act at all times to promote the interests of those entities rather than their own.[73] When an individual agrees to act in a managerial role and thereby "accept[s] . . . a trust of this sort,

67 *Id.*

68 Sealy, *supra* note 65, at 70-72. R

69 *See* Terry A. O'Neill, *Employees' Duty of Loyalty and the Corporate Constituency Debate*, 25 CONN. L. REV. 681, 684-85 (1993).

70 "Fiduciary obligation is one of the most elusive concepts in Anglo-American law. . . . [D]eveloped through a jurisprudence of analogy rather than principle . . . [it] resists tidy categorization." Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 879.

71 Officers and directors were considered the appropriate bearers of these duties because of the early conceptualization of the firm as a glorified partnership. As such, the duties already placed on partners naturally were extended to corporate management. *See* 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1 (West 1999) (1938). Now, of course, majority shareholders may also be considered subject to the same duties. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 306 (1939); Zahn v. Transamerica Corp., 162 F.2d 36, 42 (3d Cir. 1947).

72 Some now include other duties to the list of fiduciary controls on corporate management including the duty to monitor and the duty to act in good faith. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967-72 (Del. Ch. 1996); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 456-82 (2004). This section of discussion is limited to the duties of care and loyalty because of their place in the historic development of fiduciary duty doctrine.

73 *See generally* Alan R. Palmiter, *Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence*, 67 TEX. L. REV. 1351 (1989).

[that] person is obliged to execute it with fidelity and reasonable diligence."[74] This obligation imposed heavy burdens. As stated in florid prose by Justice Cardozo in the seminal case of *Meinhard v. Salmon*,[75] a fiduciary

> is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. 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. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.[76]

Cardozo's powerful, if overblown, rhetoric in *Meinhard* appealed to morality and a sense of personal worth and responsibility, calling for a fiduciary to resort "to his own conscience, his own understanding of how he would be perceived, in conducting himself."[77] The duties of care and loyalty drew on these grand notions and (in rhetoric at least) demand high standards of performance from corporate managers.

Recall that in the early stages of American corporate development, the corporation was conceptualized as a glorified form of partnership.[78] As a result, directors and officers owed shareholders duties of loyalty and care just as a partner was held to comparable duties. But what precisely did these duties entail? With no clear regulatory definition available,[79] the task of defining the parameters of each duty was left to the common law.

The common law of fiduciary duty began to develop in the mid-nineteenth century with the increase in size and complexity of corporate activities. The following sections trace the devolution of the duties of care and loyalty.

---

[74] Charitable Corp. v. Sutton, (1742) 26 Eng. Rep. 642, 645 (Ch.).

[75] 164 N.E. 545 (N.Y. 1928). In *Meinhard*, two partners were engaged in a joint venture. *Id.* at 545-46. Without the other partner's knowledge, the more knowledgeable partner entered into an extraneous agreement to buy surrounding land in order to increase his wealth. *Id.* at 546. An action alleging breach of the joint venture agreement ensued. *Id.*

[76] *Id.* (citing Wendt v. Fischer, 154 N.E. 303 (N.Y. 1926)).

[77] Lawrence E. Mitchell, *The Importance of Being Trusted*, 81 B.U. L. REV. 591, 616 (2001).

[78] HURST, *supra* note 6, at 77-78.

[79] *See, e.g.*, DEL. CODE ANN. tit. 6, § 15-404 (2005) (general standards of partner's conduct); *id.* tit. 8, § 141 (2004); *id.* tit. 8, §§ 144, 160, 271 (2004) (general corporation law); *id.* tit. 12, § 4901 (2004) (durable power of attorney).

1. Duty of Loyalty

The duty of loyalty acted as a rule protecting against self-interested behavior and "provid[ing] against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of [moral] duty."[80] To encourage appropriate fiduciary behavior, the law originally imposed a blanket prohibition on self-interested transactions. Establishing a very clear baseline, corporate fiduciary duty of loyalty doctrine provided that *any* transaction between a corporate officer or director and his or her corporation was automatically voidable.[81] It made no difference if disinterested directors or shareholders approved the transaction nor if the director or officer could prove that it was fair. The law was inflexible in application—a strong indication of the distrust with which corporations were considered at that time.

This blanket prohibition on interested director transactions found expression in the "exclusive benefit rule." This rule required directors (i.e., fiduciaries) to act for the exclusive benefit of their beneficiaries.[82] The exclusive benefit rule applied even when the fiduciary could benefit at no cost to the beneficiary.[83] The law required from a fiduciary "peremptorily and inexorably, the most scrupulous observance of [this] duty . . . . [A]n undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."[84]

What justified the imposition of an absolute ban on self-interested transactions? To understand the starting point of corporate fiduciary duty of loyalty doctrine, it is important to remember the

---

80 Michoud v. Girod, 45 U.S. (4 How.) 502, 555 (1846).

81 *See, e.g.*, Munson v. Syracuse, Geneva & Corning R.R. Co., 8 N.E. 355, 358 (N.Y. 1886) (stating the rule that all contracts made by a trustee or fiduciary in which he or she is personally interested may be invalidated at the election of the party that the trustee or fiduciary represents); *see also* Harold Marsh, Jr., *Are Directors Trustees?: Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966). It should be noted that while this is a widely accepted statement, it is not free from doubt. *See* Norwood P. Beveridge, Jr., *The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, 41 DEPAUL L. REV. 655, 659 (1992) ("It is submitted that this proposition [of automatic voidability] is completely erroneous.").

82 *See generally* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1782-83 (2001) (explaining the difference between fiduciary relationships and contractual relationships).

83 *Id.*

84 Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

historic development of corporations. When the duty of loyalty came into being in the corporate context, corporations were a new form of entity. Unlike partnerships, which preceded the corporate form, participants in a corporation did not necessarily know one another. The exclusive benefit rule helped establish a culture of trust in this newly formed business entity. Shareholders would entrust their savings to strangers because they trusted those individuals to act in their best interest. Officers and directors lived up to this trust because to do otherwise would not only break the law but also would breed an atmosphere of mistrust and reduce the viability of the corporate form. The duty of loyalty was firmly rooted in notions of truth, justice, and morality. This, in turn, encouraged trust in business fiduciaries, which worked to the benefit of all concerned. Courts of the day were not hesitant to acknowledge the importance of these values in their discussions of the doctrine, stating that to have a contrary rule "would be to overturn principles of equity which have been regarded as well settled . . . to be founded on immutable truth and justice, and to stand upon our great moral obligation to refrain from placing ourselves in relations which excite a conflict between self interest and integrity."[85]

2. *Duty of Care*

The historic baseline for the duty of care cannot be stated as succinctly as that for the duty of loyalty. It is clear that from its inception, the duty of care deviated to some degree from strict fiduciary notions. Whereas traditional fiduciary doctrine would hold directors liable for any harm to beneficiaries resulting from directorial action that violated a stringent duty, the duty of care would always afford directors significant protection, even when their actions did cause harm to their beneficiaries. Why is this so? Why should the duty of care impose any lesser standard than that of the duty of loyalty?

The answer lies in the development of the corporation and the changing conceptualizations and treatments of that form. During the latter half of the nineteenth century, corporations were becoming increasingly important in American economic life, while restrictions on their activities were being eliminated. The rise of general incorporation statutes, together with the diminishment of

[85] Cumberland Coal & Iron Co. v. Sherman, 30 Barb. 553, 578-79 (N.Y. Gen. Term 1859).

ultra vires doctrine,[86] evidenced a willingness and desire to allow corporations greater leeway in conducting their affairs. In step with this understanding of the appropriate role of corporations in American life came the understanding that directors and managers had to have some degree of freedom in their management of such entities. Thus, rather than impose strict fiduciary duty of care obligations on directors, early court decisions articulated the duty of care applicable to directors as close to a negligence standard of care, finding directors liable only when they failed to exercise "ordinary knowledge," defined as "common sense, and ordinary attention."[87]

This negligence standard is clearly more protective of directors than a strict fiduciary standard where directors shall cause no harm, however inadvertent. The lower threshold for directorial liability was deemed necessary so that directors would not be penalized for making risky, but necessary, business decisions. Recognizing the imperfections of human knowledge, the liberal baseline set by the historic duty of care doctrine protected fallible directors. To do otherwise, as has long been recognized, would demand "extreme accuracy of knowledge from this or any other class of agents, to whom of necessity a large discretion in the choice of means must be entrusted."[88]

As with the duty of loyalty, setting this standard for the duty of care facilitated the development and functioning of business in America. Reducing the likelihood that a director would face personal liability increased the chances that qualified individuals would agree to serve and encouraged those who did serve to make risky but necessary corporate decisions. At the same time, in keeping with fiduciary analysis, the standard did not cleanse

---

[86] The doctrine of ultra vires, meaning "beyond the power," made voidable any act undertaken by a corporation that was not specifically permitted by its charter. Until the mid-1800s, ultra vires acted as a serious constraint on corporate behavior. *See, e.g.*, Commonwealth v. Erie & N.E. R.R. Co., 27 Pa. 339, 351 (1856) ("A doubtful charter does not exist; because whatever is doubtful, is decisively certain against the corporation."); FRIEDMAN, *supra* note 14, at 518-19 (discussing the use of ultra vires in the mid-1800s). R

[87] Percy v. Millaudon, 8 Mart. (n.s.) 68, 77-78 (La. 1829); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, but Not Too Late*, 43 AM. U. L. REV. 379, 391-92 (1994) (discussing the history of the business judgment rule).

[88] Godbold v. Bank at Mobile, 11 Ala. 191, 199 (1847); Jay P. Moran, Comment, *Business Judgment Rule or Relic?:* Cede v. Technicolor *and the Continuing Metamorphosis of Director Duty of Care*, 45 EMORY L.J. 339, 354 (1996) (discussing the origin of the business judgment rule).

all directorial action but kept a strong focus on the impact of directorial action on corporate beneficiaries. If shareholders claimed a breach of the duty of care, courts examined the harm caused by the directors' actions and their reasons for these actions in order to determine the level of negligence involved. Thus, while setting the bar lower than absolute fidelity to shareholder welfare, the historic baseline of the duty of care comported with the general position of traditional fiduciary doctrine.[89]

Corporate fiduciary duty arose as part of a system where law and equity worked together to promote selfless behavior. This scheme demanded that corporate fiduciaries cede the immediate pursuit of self-interest for the good of their beneficiaries[90] and always bear in mind the impact of their actions on shareholders. Strict fiduciary ideals bred trust in the corporate system and supported the economic structure of business.

With this understanding of the historic bases of corporate fiduciary duty doctrine, let us now examine the development and evolution of the doctrine of fiduciary duty by considering briefly the devolution of the duties of care and loyalty.

B. Devolution of Corporate Fiduciary Duty Doctrine

As discussed above, corporate fiduciary duty doctrine originally placed meaningful demands on directors. The duty of loyalty doctrine originally held director-fiduciaries liable for any benefits they obtained in the presence of a conflict of interest. Duty of care doctrine compelled directorial concern and attention as to the well-being of their beneficiaries by examining the impact of directorial action on shareholders and requiring directors to exercise meaningful care.[91] The absolute prohibitions as-

[89] *See generally* Stephen J. Lubben & Alana Darnell, *Delaware's Duty of Care*, 31 DEL. J. CORP. L. 589 (2006) (analyzing current state of director duty of care in Delaware).

[90] This is not to suggest that fiduciaries are purely selfless. More often than not, fiduciaries receive fees for their service.

[91] *See, e.g.*, Briggs v. Spaulding, 141 U.S. 132, 152 (1891) (explaining that defendant directors are only bound to a level of care "that ordinarily prudent and diligent men would exercise"); Otis & Co. v. Pa. R. Co., 61 F. Supp. 905, 910-11 (E.D. Pa. 1945) (requiring directors to exercise care, skill, and diligence that ordinary prudent individuals would exercise in similar circumstances), *aff'd* 155 F.2d 522 (3d Cir. 1946); Anderson v. Akers, 7 F. Supp. 924, 928 (W.D. Ky. 1934) ("It is . . . a well-settled general rule that, even in the absence of a statute . . . directors . . . are bound to exercise . . . the degree of care which a reasonably prudent director . . . would

serted by the duty of loyalty and the significant prudence demanded by the duty of care doctrine have long since vanished from corporate fiduciary duty. At this point we must ask, what happened? How did the fiduciary standards of loyalty and care develop and change over time? The trajectory of doctrinal shift differs with respect to loyalty and care. Each is considered below.

1. Duty of Loyalty Evolution

a. Elimination of the Absolute Ban on Self-Interested Transactions

Though the ban on self-interested transactions was firmly in place during the nineteenth century through enforcement of the exclusive benefit rule, the ban's effectiveness had substantially eroded by 1910.[92] In the space of a mere thirty years, duty of loyalty doctrine devolved to a point where self-interested transactions were no longer treated as automatically voidable. Instead, they were considered valid if approved by a majority of disinterested directors and were not found to be unfair or fraudulent when challenged.[93] What caused the erosion of the prophylactic rule?

Although no definitive answer can be given, several factors may have contributed to the shift. First, the loosening of the standard corresponded with the changing nature of the corporate form. American business grew exponentially during this time, both in terms of the number of enterprises in existence and in the magnitude of individual corporations.[94] As the conduct of corporate affairs became more prevalent and more complex, courts began to loosen the demands placed on directorial action under the duty of loyalty, recognizing that under the exclusive benefit rule, "it would be difficult to conduct the affairs of the multifarious corporations of the country, many of which . . . are . . . practically controlled by the same directors."[95] That is, if all self-interested

exercise."), *modified in* 86 F.2d 518 (6th Cir. 1936), *rev'd on other grounds*, 302 U.S. 643 (1937).

[92] *See* Marsh, *supra* note 81, at 39-40. R

[93] *Id.* at 40 (citing numerous cases establishing this rule).

[94] *See generally* David Skeel, Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From (2005).

[95] Genesee & W.V. Ry. Co. v. Retsof Min. Co., 36 N.Y.S. 896, 901 (N.Y. Sup. Ct. 1895).

transactions were automatically void, business would be severely hobbled.

Another explanation for the loosening of the exclusive benefit rule was the fact that self-interested transactions often work to the advantage of both the directors *and* their corporations. It is overly simplistic to assume that simply because a director benefits, the corporation is harmed. For example, a director may make a loan to his corporation on more favorable terms than the corporation could otherwise obtain. While the director certainly may benefit financially from this transaction, so too does the corporation. Loosening the exclusive benefit rule permitted these and other mutually beneficial transactions to occur.

While removal of the exclusive benefit rule represented a significant step away from the historic baseline created by the duty of loyalty, the doctrine still continued to impose meaningful restraints on directorial behavior. By both requiring that transactions raising a specter of conflict of interest receive disinterested approval and examining the fairness of the transaction, courts continued to place emphasis on the well-being of shareholder beneficiaries. Disinterested approval, coupled with the ability of a beneficiary to challenge any transaction perceived to be unfair, came to be considered sufficient protection under the duty of loyalty doctrine.

b. Elimination of Disinterested Approval Requirement

The next shift in the standard imposed by the fiduciary duty of loyalty occurred between 1910 and 1970. During this period, courts modified the duty of loyalty from allowing self-interested transactions only with disinterested majority approval and subject to a fairness challenge, to one permitting self-interested transactions without disinterested approval provided a court did not later find the transaction unfair.[96] This shift meant that *all* directors could be interested in a transaction without it becoming

---

[96] This shift did not occur without protest. In one of the most influential books on corporate law ever written, Adolf Berle and Gardiner Means argued against a loosening of fiduciary duties. Concerned that the separation of ownership and control in corporations created automatic conflicts between the interests of directors and shareholders, they advocated a trust model of corporate fiduciary duty that retained higher fiduciary standards. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 219-43 (Transaction Publishers 1991) (1932); *see also*, William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 762-65 (2001).

voidable because of a breach of the duty of loyalty. This signaled a markedly different position than that established by the baseline duty of loyalty. Disinterested approval was still desired but not mandatory. What laid behind this shift?

One factor explaining the shift is that it was not always possible to receive disinterested approval of a transaction. At times, all directors and all shareholders may be involved. Arguably, this fact alone should not preclude a beneficial transaction from occurring, though that would be the case if an absolute requirement of disinterested approval was maintained. A second rationale for the move may be found in the continued influence of corporations and their managers in the United States economy. A need to facilitate business growth and accommodate those responsible for promoting that growth explains the loosening of duty of loyalty constraints.[97]

The shift did not remove all limitations on directorial behavior, however. Courts could, at the request of shareholder beneficiaries, examine a transaction for fairness ex post.[98] If that examination revealed that the transaction was not fair to shareholders, the court could declare it void under the duty of loyalty.[99] Thus, while some notion of protecting shareholder beneficiaries remained, the baseline of duty of loyalty analysis shifted markedly during this time. The focus on the protection of beneficiaries that led to the automatic blocking of any conflicting-interest transaction was gone. Instead, the class intended to be protected had to take affirmative action to challenge a transaction.

This shifting of the baseline was not necessarily an undesirable outcome, although the cases that created this shift do not explain their rationale for doing so.[100] An absolute ban on any transaction in which there is a perceived conflict of interest could prevent economically efficient outcomes.[101] What is important to

---

[97] *See generally* William E. Nelson, *The Law of Fiduciary Duty in New York, 1920–1980*, 53 SMU L. REV. 285 (2000).

[98] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983).

[99] *See* Judd F. Sneirson, *Merger Agreements, Termination Fees, and the Contract-Corporate Tension*, 2002 COLUM. BUS. L. REV. 573, 586-87.

[100] *See* Marsh, *supra* note 81, at 40 ("One searches in vain in the decided cases for a reasoned defense of this change in legal philosophy . . . .").

[101] *See* MODEL BUS. CORP. ACT §§ 8.60-8.63, introductory cmt. (1984). The judicial action prescribed by the code states:

> A director's conflicting interest transaction may not be enjoined, set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation, because the

bear in mind is that this shift in court-imposed constraints on corporate managerial behavior under the fiduciary duty of loyalty occurred concurrently with the decline in externally imposed regulatory control over fiduciary duty.[102] This combination of forces created a growing vacuum in the model of control over corporate managerial behavior.

c. *Rise of Safe Harbor Statutes in the Duty of Loyalty Context*

As set forth in the preceding section, from approximately 1910 to 1970 fiduciary duty of loyalty doctrine underwent a significant shift from its historic baseline. This change was evident from courts' substitution of an absolute ban on self-interested transactions with a rule cleansing such transactions if they were approved by a majority of disinterested directors or deemed fair by a court. In the 1980s and 1990s, this shift in fiduciary duty of loyalty doctrine was cemented with the rise of safe harbor statutes cleansing transactions deemed "fair."

Safe harbor statutes governing self-interested transactions captured the common law shift in duty of loyalty doctrine. Typically these statutes substantially protect directors if the transaction in question is authorized by a disinterested majority of directors or shareholders, or, in the absence of disinterested approval, the transaction is deemed "fair."[103] Although safe harbor statutes typically mandate the availability of judicial review, in practice

---

> director, or any person with whom or which he has a personal, economic, or other association, has an interest in the transaction, if:
>
> (1) directors' action respecting the transaction was at any time taken in compliance with section 8.62;
>
> (2) shareholders' action respecting the transaction was at any time taken in compliance with section 8.63; or
>
> (3) the transaction, judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.

Id. § 8.61.

[102] Of course, in some areas external regulation was prevalent during this time. Consider, for example, the strict regulations imposed upon corporations and their directors by the Securities Act of 1933 and the Securities Exchange Act of 1934, among others. For the most, however, these acts part detailed substantive disclosure obligations rather than normative obligations of fiduciary duty.

[103] Section 144 of the Delaware General Corporation Law cleanses self-interested transactions if any of three conditions is satisfied:

> (1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of

whether that review will be forthcoming depends on the context in which the transaction occurs. If a conflict of interest exists for a director or officer[104] and a majority of disinterested directors approve the questionable transaction in good faith after disclosure of material facts, courts will choose not to review it.[105] Once disinterested approval is received, the business judgment rule[106] applies and all but insulates directors (including those with a conflict) from liability.[107] A similar result occurs when disinterested approval is received from shareholders. Only when no disinterested approval can be obtained will the substance of the transaction be examined for fairness.

The continued emphasis on disinterested approval and the use of the term "fair" in the safe harbor statutes suggests that traditional notions of fiduciary doctrine and the impact of directorial action on shareholder beneficiaries will still have an important role to play in assessing directorial conduct. In truth, however, closer examination of the impact of safe harbor statutes in the duty of loyalty context demonstrates several reasons for their ineffectiveness in imposing any real constraint on managerial behavior.

One serious impediment to the duty of loyalty exercising any real control over management behavior under the safe harbor statutes lies in the determination of what "disinterested" means.[108] Recall that if a transaction receives "disinterested" ap-

> a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or
>
> (2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or
>
> (3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the shareholders.

DEL. CODE ANN. tit. 8, § 144(a)(1)-(3) (2001).

104 The standard of review may be different when the conflict of interest exists between the corporation and a controlling shareholder. Because the controlling shareholder has the ability to dominate the board and take retaliatory action if the transaction is not approved, a court will review the substantive fairness of the transaction for the corporation and the noncontrolling shareholders. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997).

105 *See* 1 DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 274-75 (5th ed. 1998).

106 The business judgment rule is discussed *infra* Part II.B.2.a.

107 *See* 1 BLOCK ET AL., *supra* note 105, at 274-75.

108 For a thoughtful, detailed discussion of this issue, see J. Robert Brown, Jr.,

proval, no fairness inquiry is made. Disinterested is not defined in the safe harbor statutes. While those statutes sanitize transactions approved by disinterested directors or shareholders, they do not require that those with an interest in a transaction refrain from discussing it with parties that will vote. This presents a strong possibility that interested individuals can exert influence over the vote, especially in the case of self-interested directors who present a proposed transaction to their fellow directors or shareholders.

Another significant problem with the disinterested approval requirement is that such approval theoretically should be based on full information about the proposed transaction, but under current law, directors often need not disclose many relevant pieces of information. For example, under Delaware law, directors need not disclose alternative valuations of a transaction[109] or the existence of alternative offers,[110] among other information. Shareholders' limited ability to obtain full information about a transaction undermines the utility of their "disinterested" approval. Thus, any attempt to obtain truly disinterested approval faces significant structural and procedural impediments.

Another problem in this area is determining what a "fair" transaction is. Although courts are authorized to police the fairness of a transaction when no disinterested approval is received, in truth little of this occurs.[111] To mention just one of the problems that prevent courts from conducting a meaningful review, consider that fairness questions usually center on the price of the transaction, which can typically be stated within a range. The choice of an appropriate price within that range is then viewed as a business decision properly made by directors. Courts are then, on the one hand, unwilling to challenge that judgment and, on the other, reluctant to enter into the valuation fray.[112] The result is that if directors can show that the price of a transaction fell within an acceptable range, courts will not question the fairness of it.

Speaking with Complete Candor: Shareholder Ratification and the Elimination of the Duty of Loyalty, 54 HASTINGS L.J. 641 (2003).

109 *See, e.g.*, *In re* Vitalink Commc'ns Corp. Shareholders Litig., No. 12085, 1991 WL 238816, at *13 (Del. Ch. Nov. 8, 1991).

110 *See* Brown, *supra* note 108, at 681 & n.197.

111 For an in-depth discussion of this problem, see Park McGinty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 EMORY L.J. 163 (1997).

112 *See* Smith v. Van Gorkom, 488 A.2d 858, 875-78 (Del. 1985).

With these significant problems in mind, it is clear that the safe harbors sterilize many transactions. Under current duty of loyalty jurisprudence, "disinterested" does not mean disinterested, and "fair" focuses on process rather than content. Thus, the safe harbor statutes place little meaningful fiduciary demands on corporate management. As long as "disinterested" directors follow appropriate processes, courts generally will not review the directors' decisions, leaving them free to act as they see fit. It seems fair to say that "as currently operationalized, the duty of loyalty is hardly more than a matter of process [and is] mostly comatose."[113]

So we arrive at a point where theoretical conceptualizations of the corporation mandate little or no external regulation of corporate management in the belief that an underlying safety net of the duty of loyalty exists. But as shown, the duty of loyalty doctrine is largely nonexistent and cannot fulfill the role envisioned for it. As the next section shows, a similar state of affairs is revealed in an examination of the duty of care.

2. *Duty of Care Evolution*

a. *Early Rise of the "Business Judgment Rule"*

As discussed above, the law has long held corporate directors to a truly "fiduciary" duty of care. In recognition of the fact that corporate managers often must make risky decisions, fiduciary duty doctrine addressing the duty of care traditionally afforded directors significant leeway. In essence, the law recognized that directors should not bear personal liability for those decisions that turn out in hindsight to have been ill considered.[114] As the doctrine developed, this long-held view found formal expression in the "business judgment rule." Under this rule, directors' decisions are presumed to have been made "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[115] Unless shareholders can

---

[113] McGinty, *supra* note 111, at 169-72.

[114] *See, e.g.*, Hodges v. New Eng. Screw Co., 1 R.I. 312, 346 (1850) ("If . . . the mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the [corporation], they ought not to be liable."); Charitable Corp. v. Sutton, (1742) 26 Eng. Rep. 642, 644 (Ch.).

[115] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Earlier pronouncements of the idea encapsulated by the business judgment rule are found in cases that predate general corporation laws. *See, e.g.*, *In re* Mansfield Ry., Light & Power Co., 3 Ohio

rebut this presumption, courts generally will not impose personal liability on corporate directors for their actions.[116]

The business judgment rule represents a highly unusual application of fiduciary standards. It is true that the initial justification for the rule was based on notions of fairness and equity—the very notions that underlie traditional fiduciary analysis. Here, however, the fairness concern was more with the fiduciary-directors and less with the beneficiary-shareholders. What justified this unique understanding of "fiduciary" duty?

A primary justification for the business judgment rule comes from economically based rationale. That is, "consistent with the business corporation's profit orientation, business judgment [exercised by directors] inevitably involves risk evaluation and assumption."[117] Essentially, because directors must make risky decisions if their corporations are to maximize profits, they must be protected when those decisions do not have the desired result. Absent the protection afforded them by the business judgment rule, directors will be discouraged from future profit-enhancing decisions.[118] The economic rationale for the business judgment rule within duty of care analysis was, in some sense, in keeping with traditional fiduciary doctrine. Directors were given the protection of the business judgment rule so that they could more freely act to enhance corporate profits, which in theory, redounded to the benefit of their beneficiary-shareholders. Further, the presumptive protection of the business judgment rule attached only because directors were still required to act in the best interest of their corporation and its shareholders.[119] Thus,

App. 253, 265-66 (1914) (holding that corporate managers must exercise care to act solely in their corporation's best interest).

[116] Keyser v. Commonwealth Nat'l Fin. Corp., 675 F. Supp. 238, 257 & n.22 (M.D. Pa. 1987) (citing Weiss v. Temporary Inv. Fund, Inc., 692 F.2d 928, 941 (3d Cir. 1982)).

[117] Bayless Manning, *The Business Judgment Rule in Overview*, 45 OHIO ST. L.J. 615, 617 (1984) (quoting Am. Bar Ass'n Comm. on Corp. Laws, *Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1603-04 (1978)).

[118] The need to insulate directors when they engage in risky behavior is reinforced by the different positions occupied by directors and shareholders with respect to risk. Though risky ventures pose the greatest likelihood for high return, they also pose the greatest likelihood for substantial losses. Directors may favor that risk while shareholders may be more risk averse, preferring a more certain, if smaller, return from a less risky investment. *See* Joy v. North, 692 F.2d 880, 889 (2d Cir. 1982).

[119] *See* Janet E. Kerr, *Delaware Goes Shopping for a "New" Interpretation of the* Revlon *Standard: The Effect of the* QVC *Decision on Strategic Mergers*, 58 ALB. L. REV. 609, 613 (1995).

directors were required to demonstrate a certain level of skill and attention in their exercise of corporate affairs and were required to make decisions based on sufficient research and information before the protective presumption of the rule attached.

With duty of care analysis premised on an economic justification, it was uncommon, but not unheard of, for beneficiary-shareholders to prevail in a claim against corporate managers for breach of this duty. Until the mid-1980s, fiduciary duty of care could still be said to constrain managerial behavior to a limited degree as demonstrated by the seminal case of *Smith v. Van Gorkom.*[120]

In brief, *Van Gorkom* addressed a minority shareholder's claim that the board of Trans Union breached its fiduciary duty of care by approving a merger.[121] The Delaware Supreme Court agreed,[122] to the amazement and horror of most of the business community.[123] The court made clear in its opinion that it was not deciding whether the merger itself was a good or bad deal for Trans Union and its shareholders;[124] instead, the court was considering only the *process* by which the board reached its decision to engage in the transaction.[125] Essentially, the court found that because the board acted quickly, without full and credible information, it was not entitled to business judgment rule protection and, absent that protection, was personally liable for breaching its duty of care.[126] *Van Gorkom* showed that the courts were still willing to pay lip service to the notion of fiduciary duty of care,

---

120 488 A.2d 858 (Del. 1985). Another often-cited duty of care case imposing liability by denying business judgment rule protection is *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981). Due to the egregious nature of its facts, *Francis*, which involved the duty to monitor, is not particularly relevant to a general discussion of the protection extended by the business judgment rule. While it is very fun to read, its facts are so extreme as to have little precedential importance.

121 *Van Gorkom*, 488 A.2d at 863.

122 *Id.* at 872.

123 *See* Gerard C. Martin, Comment, *Duties of Care Under the Revised Uniform Partnership Act*, 65 U. CHI. L. REV. 1307, 1327 (1998) ("In *Van Gorkom*, the Delaware Supreme Court held that the business judgment rule did not protect decisions by corporate directors who were not 'reasonably informed.' The *Van Gorkom* decision sent shockwaves through the corporate legal community largely because the court's approach to the business judgment rule was so unprecedented. The reaction included a virtual disappearance of directors' and officers' insurance, threats by corporations to leave Delaware, and, ultimately, legislative action to permit corporations to reduce the risk to their directors.").

124 *Van Gorkom*, 488 A.2d at 889.

125 *Id.*

126 *Id.* at 893.

although, as noted by one scholar, "Courts often commence their opinions with the stern but tired maxims of fiduciary duties . . . only to subsequently invoke the purifying balm of the 'business judgment rule' . . . to preclude inquiry into the merits of directors' decisions . . . ."[127] At this stage of the duty of care's devolution, process review had largely supplanted substantive review and greatly undermined the capability of fiduciary doctrine to exercise meaningful restraint.

b. *Virtual Elimination of Meaningful Fiduciary Duty Constraints*

In reaction to the decision in *Smith v. Van Gorkom*, Delaware enacted section 102(b)(7) of its Corporation Code, enabling directors to avoid personal liability for most breaches of fiduciary duty.[128] Other states quickly followed suit with the result that statutory protection for breaches of fiduciary duty is now available to directors in every state.[129] Naturally, once such protection became available, corporations essentially became required to include the necessary language in their corporate charters if they wanted to have any chance of attracting and retaining well-qualified directors. According to one study, "over 90% of a random sample of 180 Delaware firms adopted a limited liability provision within one year of [section 102 (b)(7)'s] enactment."[130] Anecdotal evidence gathered by the author suggests that these statistics remain constant today.[131] It is fair to say that the vast majority of corporate charters now prevent directors from suffer-

---

[127] Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 593-94 (1983).

[128] The relevant provision permits a certificate of incorporation to include:

> A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director . . . for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . .

DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

[129] *See* James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1209-31 (1988); *see also* Brown, *supra* note 108.

[130] Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160-61 (1990).

[131] Interview with Mr. James L. Holzman, Esq., Member, Delaware Corporations Council (date unavailable). A search of SEC filings (where the adoption of section 102(b)(7) must be disclosed) in Delaware from July 2001 to July 2002 indicates that

ing personally for their "bad actions."[132] While nominally subject to duties of care and loyalty, directors in most cases need not be overly concerned. Effectively, the terms of their corporate contracts eliminate any meaningful fiduciary demands.

c. *The Rise of the Contractarians and the Final Death of the Duty of Care*

The rise of the contractarian conceptualization of the corporation in the 1980s to a large degree provided the theoretical justification for the virtual elimination of traditional fiduciary duty analysis. For contractarians, generally one simple rule of fiduciary duty can be articulated: it does not exist.[133] For this group fiduciary duties are not special duties. Rather, "they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings."[134] Because *all* corporate matters can be regulated by contract, parties in the corporate enterprise can freely draft whatever provisions they choose with regard to fiduciary duty.[135] In brief, for contractarians, because the market adequately polices corporate management behavior, there is no need for a special doctrine of fiduciary duty.[136] According to the group's leading lights, "there is no subject here, and efforts to unify [the concept of fiduciary duty] on a ground that presumes its distinctiveness are doomed."[137] While contractarians may acknowledge the existence of fiduciary duty, they do not give it any special weight. Instead, corporate constituents are entitled only to those protections specified in the contract they enter into as part of the corporate enterprise.

While courts may not vocally accept the contractarian conceptualization of the firm and its conclusions regarding fiduciary duty, we have seen in practice that the doctrine has reached a point where it exercises no real power over corporate managers. While courts may continue to pay lip service to traditional no-

---

virtually every firm making an SEC filing in that time period included the provision in its corporate charter.

[132] *Id.*

[133] *See* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993).

[134] *Id.*

[135] Barry D. Baysinger & Henry N. Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179, 179-80 (1985).

[136] Easterbrook & Fischel, *supra* note 133, at 438.

[137] *Id.*

tions of fiduciary duty, they have ceased giving it meaningful content. What was to serve as the critical safeguard as external regulatory controls were loosened has itself been largely erased.

So here we move 180 degrees from Cardozo's statement that fiduciary duty requires a "punctilio of an honor the most sensitive,"[138] an honor to be monitored and enforced by judicial oversight. Instead of a view that fiduciary duties are important, meaningful obligations based on moral precepts, we now find the position that if parties choose to eliminate duties entirely, they are free to do so without interference.

Conclusion: Signs of Revival in Regulation and Fiduciary Doctrine

The preceding discussion shows how historical conceptualizations of the corporation led to a relaxation of external regulatory control over firms and their management. Examination of the devolution of corporate fiduciary duty analysis shows that courts no longer insist on strict adherence to traditional notions of fiduciary duty. And so we are left with a vacuum in the area of regulatory control over corporate management. In this vacuum, the types of corporate malfeasance commonplace today do not seem so surprising.

An important question now faces corporate scholars and the courts: what should be done about this sorry state of affairs? Several possibilities exist. One could focus on the regulatory side of the regulation/fiduciary duty equation. In that scenario, different options abound. One extreme, consistent with the contractarian approach, would counsel doing nothing. Under this approach, the market will sort out the bad actors and self-correct. External tinkering would only inappropriately disrupt market forces. A second, radically different view would argue for a ramp up in external regulation. This approach had some footing as legislators and regulators rushed to implement reforms in reaction to the Enron scandal and other debacles. Sarbanes-Oxley and the rule changes of some self-regulatory agencies[139] exemplify this approach. Either of these approaches presents possibilities, although the likelihood of success under either seems remote. Relying on a contractarian market-driven response did

[138] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). *See also supra* notes 75-76 and accompanying text.

[139] *See supra* note 2. R

not prevent the current scandals from erupting. The impact of external regulatory efforts will take time to become clear. But in the limited time that these efforts have been in place, they have generated a great deal of controversy as to their effectiveness.[140]

Instead of focusing on the statutory/regulatory approach toward controlling corporate behavior, one could instead look back to fiduciary duty doctrine. Recall the main justifications for imposing mandatory corporate fiduciary duties: first, promoting trust and protecting parties from the actions of directors with conflicting interests, and second, ensuring that directors make all decisions with the interests of their shareholders in mind. If these duties were given real content again and courts were willing to insist on compliance with them, perhaps we could begin to stem the flood of improper behavior by corporate management. As shown, courts now, while paying lip service to fiduciary duty doctrine,[141] do not routinely submit the behavior of corporate management to meaningful review; however, they should.

There is some indication that a renewed attention to fiduciary duty is possible. Several recent cases in Delaware highlight a growing emphasis on a duty of good faith.[142] The precise parameters of this duty are yet to be determined. Some commentators have argued that good faith should stand as an independent fiduciary obligation such that a failure to act in good faith could give rise to liability.[143] However, the Delaware Supreme Court appeared to end this argument in *Stone ex rel. AmSouth Bancorporation v. Ritter*.[144] In *Stone*, the court clearly announced that "a failure to act in good faith is not conduct that results, *ipso facto*,

[140] *See, e.g.*, *SOX Backlash Emerges as Managers Consider Total Cost of Compliance*, ACCT. DEP'T MGMT. REP. (IOMA, New York, N.Y.), July 2004, at 5; Judith Burns, *Is Sarbanes-Oxley Working?*, WALL ST. J., June 21, 2004, at R8; Edward Iwata, *Businesses Say Corporate Governance Can Go Too Far*, USA TODAY, June 24, 2004, at 1B.

[141] Allen, *supra* note 57, at 72. ("The most remarkable feature of U.S. corporation law generally, and Delaware particularly, is the great importance that it gives to the fiduciary duty concept and the resulting power of courts to apply ex post evaluations of many important types of transactions.").

[142] *See, e.g.*, Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (discussing permutations of good faith); *In re* Walt Disney Co. Derivative Litig., 825 A.2d. 275 (Del. Ch. 2003); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d. 959 (Del. Ch. 1996) (discussing the duty of good faith).

[143] *See* Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006); Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123 (2006).

[144] 911 A.2d 362 (Del. 2006).

in the direct imposition of fiduciary liability."[145] In the court's view, an action taken in bad faith may give rise to a claim of breach of the duty of loyalty because the duty to act in good faith is subsumed within that duty, but it does not operate outside that duty to create a third base of liability.[146] In no uncertain terms, *Stone* establishes that "the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty."[147]

Although the court refused to create an independent duty of good faith, it did not minimize the importance of the requirement that corporate directors act in good faith. Instead, the court stated that the requirement of good faith action by directors means that "the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith."[148]

Precisely where these statements place the role of good faith remains to be seen. What is clear is that cases such as *Caremark International,*[149] *Walt Disney Co.*,[150] and *Stone* have revitalized a fiduciary duty discussion in the courts and among commentators.[151] The vibrant discourse regarding fiduciary duties sparked by these cases and all-too-real–world events brings renewed hope that fiduciary duty doctrines can exert some meaningful control over corporate behavior.

Although we have seen the dismantling of classic conceptions of the corporation and a severe decline in the effectiveness of fiduciary duty doctrine, change *is* possible. As Grant Gilmore stated: "[T]here are alternating rhythms of classicism and romanticism. . . . Perhaps we should admit the possibility of such alternating rhythms in the process of the law."[152] With public outrage over corporate mismanagement running high, we have a window of opportunity to reassert and revitalize corporate fiduciary duty. Fiduciary duty is dead—long live fiduciary duty.

---

[145] *Id.* at 369.
[146] *Id.* at 370.
[147] *Id.*
[148] *Id.*
[149] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).
[150] *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).
[151] *See, e.g.*, Mark J. Loewenstein, *The Quiet Transformation of Corporate Law*, 57 SMU L. Rev. 353 (2004); Sale, *supra* note 72. **R**
[152] Gilmore, *supra* note 63, at 102. **R**