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The Use and Misuse of Fiduciary Duties: Corporate Social Responsibility and the Standard of Review

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THE USE AND MISUSE OF FIDUCIARY DUTIES: CORPORATE SOCIAL RESPONSIBILITY AND THE STANDARD OF REVIEW

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ABSTRACT

This Article provides a crucial corrective to the "corporate social responsibility" debate, which concerns whether corporations have the obligation to protect or serve the interests of groups other than their shareholders, like employees or customers (often called "stakeholders"). Scholars on one side of the debate have repeatedly presumed that corporate directors' fiduciary duties to shareholders play an important role in protecting shareholders from decisions that favor stakeholders at their expense. Scholars on the other side agree that fiduciary duties provide meaningful protection against unfavorable conduct but argue that directors should also owe fiduciary duties to stakeholders so they may be similarly protected. This Article argues that this shared premise is mistaken: Fiduciary duties in practice play almost no role in director decisions to favor one corporate group over another. The Article first explains that courts and scholars rarely note the difference between two distinct definitions of the duty of loyalty—one broad and one narrow—and argues that only the broader definition would allow this duty to have any impact on directors' distribution of corporate resources. Under this narrow definition, fiduciary duties to shareholders prevent directors from acting in their own self-interest, but not from acting in the interests of stakeholders at shareholders' expense. The Article then argues that Delaware law enforces only the narrow definition of loyalty due to its default judicial standard of review, the business judgment rule, which largely eliminates shareholders' ability to protect themselves from directors' decisions that favor other

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stakeholders. Finally, given this is true for shareholders, the Article argues it would likewise be true for employees (or any other stakeholders), were they to be owed fiduciary duties by directors. Because fiduciary duties do not protect against such unfavorable conduct, the Article concludes it is a mistake to debate to whom directors should owe fiduciary duties. Advocates for shareholder or stakeholder protection should therefore focus on other mechanisms to obtain it.

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INTRODUCTION

If you thought corporate law was broken, how would you fix it? Maybe you hold the increasingly popular view that the law makes corporate executives too beholden to shareholder interests, and that this is ruining things for everyone else.[1] Or maybe you think, along similar lines, that employees are getting a particularly lousy deal, so the law should take additional steps to single them out for protection.[2] Or maybe you think it's really the local community or society at large that needs extra protection, given that the relentless pursuit of shareholder profits has the potential to impose massive externalities on those outside the firm.[3] Scholars

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[1] *See, e.g.*, Leo E. Strine Jr. & Nicholas Walter, *Conservative Collision Course: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 389 (2015) (arguing that "[t]he logical result of *Citizens United*, when combined with the conservative corporate theory view that corporations should only spend money on increasing stockholders' wealth, is that corporations will pour money into the electoral process to increase the returns to their stockholders. Because corporate wealth far exceeds that held directly by human beings, if corporations are able to act directly to influence who is elected to office, the laws and regulations in our society will increasingly tend to tolerate the imposition of greater externalities."); *see also* BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (July 2021), https://s3.amazonaws.com/brt.org/BRTStatementonthePurposeofaCorporation July2021.pdf [https://perma.cc/98SR-VTCT].

[2] *See, e.g.*, Matthew T. Bodie, *Employment as Fiduciary Relationship*, 105 GEO. L.J. 819, 819 (2017) ("[T]his Article argues that employers are fiduciaries and must refrain from opportunism, especially when employees have no voice in governance."); Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1194 (1991) (developing a "model [that] expands directorial fiduciary duties to encompass actions that shield workers from disruptions brought about by plant closings and other corporate changes. Such fiduciary duties toward workers would require directors to provide adequate severance payments, job retraining, and other appropriate relief to displaced workers."); *see also* Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 334 (2008) (arguing "for employee primacy in corporate governance. 'Employee primacy' has two elements: ultimate employee control over the corporation, and an objective of maximizing employee welfare").

[3] Kent Greenfield, *Saving the World with Corporate Law*, 57 EMORY L.J. 947, 949 (2008). Greenfield argues that "[c]hanges in corporate law could make it possible to take advantage of the distinctive abilities of the corporation to create

often refer to these nonshareholder groups as "stakeholders," so this Article will do the same.[4] Concerns on behalf of stakeholders are typically focused on distribution—the issue is not that a corporation creates wealth, but that its wealth is not distributed among the various constituencies appropriately.[5] Because shareholders are the only constituency (other than the corporation itself) to whom corporate directors owe fiduciary duties,[6] one proposed solution has emerged time and again: modify the law so that corporate directors owe fiduciary duties to stakeholders as well.[7] Could a "multi-fiduciary" or "multi-stakeholder" approach to corporate governance fix these distribution problems in corporate law?

Of course, many would dispute the premise that corporate law is broken.[8] They would say it is working perfectly fine, thank you, and not just for the executives and the shareholders, but also for other stakeholders, whether they be employees, customers, or society at large.[9] Proponents of this view have also laid claim to

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wealth, while making it less likely that corporations will do so through breaches of the public trust or the imposition of costly externalities on stakeholders or communities." *Id.* He argues that "directors should be held to a fiduciary obligation to all of the firm's stakeholders that varies according to the nature of the stakeholders' contributions to the success of the firm." *Id.* at 975–76.

[4] *See id.* at 949.

[5] *See id.* at 975.

[6] *See, e.g.*, N. Am. Cath. Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders."). Scholars generally agree with this purely descriptive account at a high level. *See, e.g.*, Lawrence E. Mitchell, *Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 586 (1992) ("There is probably no more frequently articulated principle of corporate law than that directors are fiduciaries of the corporation and its stockholders."). But, as explained below, that is about as far as the agreement goes. *See infra* notes 8–17 and accompanying text.

[7] *See, e.g.*, Greenfield, *supra* note 3, at 961.

[8] *See, e.g.*, Richard A. Epstein, *Elizabeth Warren's Corporate Illogic*, WALL ST. J. (Sept. 18, 2018), https://www.wsj.com/articles/elizabeth-warrens-corporate-illogic-1536705547 [https://perma.cc/A3WZ-Y8TA]; *see also* Council of Inst. Invs., *Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose* (Aug. 19, 2019), https://www.cii.org/aug19_brt_response [https://perma.cc/3LY6-5RPU].

[9] *See, e.g.*, *id.* (stating that "American corporate law provides that boards of directors are chosen solely by shareholders, to whom the directors owe an exclusive fiduciary duty to maximize shareholder value. That simple proposition

the directors' fiduciary duties, not out of concern for employees or customers (who, they contend, will get by just fine with regulatory and contractual protections),[10] but instead, as a means to secure what is considered the only proper end of corporate governance: shareholder wealth maximization.[11] Sometimes called "shareholder primacy,"[12] this view holds that the only proper goal of every corporate action is to increase shareholder wealth (within the bounds of the law),[13] and that the proper way to understand directors' fiduciary duty is simply as the duty to choose actions that best achieve that goal.[14] Much of this is also concerned about distribution: Corporate directors ought not to distribute corporate resources to stakeholders, they contend, except as a means to create further shareholder wealth.[15] And an important purpose of directors' fiduciary duties, according to this view, is to prevent directors from improperly benefiting nonshareholder groups.[16] This, in brief, is the debate about "corporate social responsibility" and the role that fiduciary duties might play in it.[17]

If all this rings with too much abstraction, let's get concrete. Imagine General Motors has a particularly successful year and closes its books with a 100% cash surplus, meaning its cash reserves are double the amount that GM's management deems necessary

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has generated benefits not only for shareholders but also for workers, suppliers, customers, bondholders and communities").

[10] *See* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1434 (1993) [hereinafter *In Defense of the Shareholder*].

[11] *See id.* at 1423.

[12] *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 106 (2020) (describing the "shareholder primacy view" as the view that "directors should focus on the welfare of shareholders").

[13] *See id.* at 106.

[14] *See id.*

[15] *See* Greenfield, *supra* note 3, at 952; *see also* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 240 (2009) (see discussion regarding corporate directors' interest in maximizing profits to the corporation's entirety).

[16] *See infra* Section IV.A.

[17] *See, e.g.*, David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After* Citizens United, 89 N.C. L. REV. 1197, 1198–99 (2011) [hereinafter *The Public Choice Problem*].

to cover its ongoing operating expenses and capital expenditures. Say it has a surplus of ten billion dollars. Are the company's directors[18] obligated to distribute the surplus to the shareholders, say, in the form of a dividend or stock buyback program? May the directors give some or all of the surplus to the company's employees in the form of annual bonuses or salary raises? Or do the directors also have an obligation to GM's customers, such that they ought to use some of the ten billion to offer lower vehicle prices or more favorable warranty packages? And what about the environment, which the company's products and production chains have possibly harmed along the way or the communities that have devoted their resources to supporting the company—do GM's directors have the obligation (or, at least, the freedom) to spend any of that ten billion on them?

This Article does not attempt to mediate this debate, at least not directly. Instead, it focuses on an unlikely agreement among the various ideological positions that fiduciary duties play an important role in the debate.[19] To make this clear, consider the vast array of proposals and arguments involving corporate fiduciary duties that scholars, courts, and legislators have offered. There have been calls for eliminating directors' fiduciary duties altogether, both on the justification that they are too restrictive[20] and that they provide no meaningful restrictions whatsoever.[21] Some scholars have argued that fiduciary duties are so important that statutes permitting parties to waive them, even in so-called unincorporated forms like the LLC, are bad policy[22] and even constitutionally

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[18] For ease of reference, this Article uses the terms "directors" or the "board" to refer to any corporate directors, officers, or managers who owe fiduciary duties to the corporation and its shareholders. *See also* Mitchell, *supra* note 6, at 586.

[19] *See infra* Section I.B.

[20] Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1315 (2008) ("Imposing duties on directors that are too rigid or too mechanical may limit the ability of investors to create capital structures that are beyond the ken of those writing the rules .... [I]t may make sense to eliminate the concept of fiduciary duty in corporate law altogether.").

[21] Alces, *supra* note 15, at 240 (arguing that the doctrine of corporate fiduciary duties "is little more than a fiction").

[22] *See, e.g.*, Rutheford B. Campbell, Jr., *Bumping Along the Bottom: Abandoned Principles and Failed Fiduciary Standards in Uniform Partnership and*

prohibited.[23] Other scholars (and some courts) continue to maintain that corporate directors should owe fiduciary duties to shareholders alone,[24] to both shareholders and employees,[25] to employees and customers,[26] to the corporation as a whole (with no special treatment for shareholders),[27] to bondholders,[28] and to creditors of insolvent or "near-insolvent" firms.[29] In addition, the language of fiduciary duty has also been used to describe corporate directors' relationships to the environment,[30] to stakeholder groups

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LLC Statutes, 96 KY. L.J. 163, 168 (2007); Daniel S. Kleinberger, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445, 465 (2009).

[23] *See, e.g.*, Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 702 (2011) (arguing "that the Delaware General Assembly is constitutionally prohibited from preventing the judges of the Delaware Court of Chancery from applying fiduciary duties as those judges think best—whether or not a private agreement purports to eliminate such duties. Judges themselves, therefore, should not refrain from applying traditional fiduciary duties as they have always done—i.e., as a particular context may equitably require") (citations omitted).

[24] *See, e.g.*, Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 44 (1991).

[25] *See, e.g.*, O'Connor, *supra* note 2, at 1194.

[26] *See, e.g.*, *The Public Choice Problem*, *supra* note 17, at 1236.

[27] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 248 (1999) [hereinafter Blair & Stout, *A Team Production Theory of Corporate Law*]; Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743, 743 (1999).

[28] *See* Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205, 206 (1988).

[29] *See, e.g.*, Cory Dean Kandestin, *The Duty to Creditors in Near-Insolvent Firms: Eliminating the Near-Insolvency Distinction*, 60 VAND. L. REV. 1235, 1238 (2007); *see also* N. Am. Cath. Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 101–03 (Del. 2007) (holding "that individual *creditors* of an *insolvent* corporation have *no right to assert direct* claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation or any *other* direct nonfiduciary claim ... that may be available for individual creditors").

[30] *See, e.g.*, Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 708 (2002) ("The concept of corporate accountability asks what duties might exist for corporations to account to society for the implications of their actions; that is, what duties might require corporations to inform society about the social, political, economic,

effected by international human rights issues,[31] to local communities,[32] and to the public in general.[33]

An implicit premise in each of these arguments is that it is extremely important *to whom* directors owe fiduciary duties, because being owed such duties would entitle that person or group to sue the directors to prevent corporate actions that improperly favor other corporate groups at their expense.[34] Because of this, scholars on all sides of the debate implicitly agree that when it comes to directors' decisions about the distribution of corporate resources, the fact that directors owe fiduciary duties to shareholders, rather than to other stakeholders like employees or customers, really matters.[35] This Article's argument is simple: it does not.[36]

The reasons for this are a bit more complicated.[37] As explained below, if a shareholder sues to challenge a board decision on the grounds that it unduly benefits other stakeholders, under current law the reviewing court is obligated to "defer to the board of directors' judgment absent highly unusual exceptions,"[38] and thus the decision will be overturned only in rare circumstances.[39] This

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and environmental consequences of managers' and directors' exercise of their fiduciary responsibilities.").

[31] *See* Cynthia A. Williams & John M. Conley, *Is There an Emerging Fiduciary Duty to Consider Human Rights*, 74 U. CIN. L. REV. 75, 77 (2005) (arguing that "boards' current fiduciary duties *to their shareholders* require them to consider the rights and interests of stakeholder groups, including those rights and interests exemplified in the international law of human rights"); Amy Lehr, *Fiduciary Duties for a Globalized World: Stakeholder Theory Reconceived*, 27 GEO. MASON L. REV. 81, 103, 131 (2019).

[32] *See* Jonathan R. Macey & Geoffrey P. Miller, *Corporate Stakeholder: A Contractual Perspective*, 43 U. TORONTO L.J. 401, 421 (1993) (considering a "set of fiduciary duties to the local community" and rejecting this proposal for other reasons).

[33] *See, e.g.*, TAMAR FRANKEL, FIDUCIARY LAW 125–26 (Oxford Univ. Press ed., 2011) (discussing "[t]he common law doctrine of public trust [that] imposes on governing bodies fiduciary duties *toward the public*" and the possibility of applying this obligation on the management of a corporation).

[34] *See infra* Part IV; O'Connor, *supra* note 2, at 955, 958–59.

[35] *See infra* Part III; FRANKEL, *supra* note 33, at 124–25.

[36] *See infra* Section I.B.

[37] *See infra* Section I.B.

[38] *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87–88 (2019) [hereinafter *Business Judgment Rule*].

[39] *See id.*

doctrine, known as the "business judgment rule," is the standard of review that courts apply when evaluating claims for the violation of fiduciary duties to shareholders.[40] The rule obliges judges to abstain from evaluating almost all board decisions, whether or not they were motivated by concern for other stakeholders.[41]

Generally speaking, the standard of review refers to the amount of deference a reviewer affords to an earlier decision-maker.[42] In the federal appellate context, for example, the standard of review determines the question an appellate court asks when reviewing a district court's decision: questions of law are reviewed de novo,[43] questions of fact are reviewed for clear error,[44] and matters of discretion are reviewed for abuse of discretion.[45] The court's determination of the correct standard of review is important, as it can determine the entire outcome of the case.[46] If the standard of review is sufficiently deferential, the appellate court may be required to affirm the decision of the district court even if it would have reached a different conclusion on its own independent judgment.[47]

In shareholder lawsuits alleging the violation of Delaware[48] directors' fiduciary duties, the initial decision-maker is typically the board of directors, and the reviewer is typically the Delaware

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[40] *See id.* at 90–91 and accompanying notes.

[41] *Id.* at 87 (arguing "that the [business judgment] rule is better understood as a doctrine of abstention pursuant to which courts in fact refrain from reviewing board decisions unless exacting preconditions for review are satisfied").

[42] *See* Maureen B. Collins, *Incorporating the Standard of Review Into Your Appellate Argument*, 90 ILL. B.J. 209, 209 (2002).

[43] *See id.*

[44] *See id.*

[45] *See* Dickinson v. Zurko, 527 U.S. 150, 162 (1999) ("The upshot in terms of judicial review is some practical difference in outcome depending upon which standard is used.").

[46] *See, e.g.*, *id.* at 162.

[47] *See, e.g.*, Krull v. SEC, 248 F.3d 907, 914 (9th Cir. 2001) (stating that the deferential standard of review "constrains us, even if we might decide otherwise were it left to our independent judgment").

[48] For the sake of simplicity, this Article focuses on corporate law in Delaware, the most important state for corporate law. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 763 (2015) [hereinafter *Dangers of Denial*] (calling Delaware "the most important American jurisdiction" for corporate law).

Court of Chancery.[49] Now, it is well known that in Delaware corporate law there is often an enormous gap between the standard of conduct—the rule directors must follow—and the Court's standard of review—the question the Court is required to ask when a plaintiff alleges a fiduciary violation.[50] Further, this gap, created by the business judgment rule, is seen by scholars and courts as fundamental to corporate law, as it secures the appropriate balance between directors' authority to manage the corporation and their accountability to judges and shareholders.[51] Any decision to modify the rule, then, should not be made lightly.[52]

Nonetheless, the corporate social responsibility debate's focus on fiduciary duties has largely failed to consider how this standard of review affects the ability of shareholders (or stakeholders who might conceivably be owed fiduciary duties) to protect themselves from directors' decisions about the distribution of resources among the various corporate constituencies, even though questions of distribution, as we have seen, are what the debate is all about.[53] In short, this Article argues that the business judgment rule virtually eliminates shareholders' ability to prevent corporate decisions they find unfavorable, even those in which other stakeholders are favored.[54] Likewise, if the law were changed such that directors were to owe fiduciary duties to other stakeholders as well, such stakeholders—holding all other rules of corporate law constant—would have virtually no power to prevent such unfavorable decisions either.[55] Regardless of who has the power to sue the board for violations of fiduciary duty, the business judgment rule will stand in their way, absent highly unusual circumstances that are described below.[56] The result is that fiduciary duties are largely irrelevant to the corporate social responsibility debate.[57]

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[49] *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

[50] *See infra* Part III.

[51] *See Business Judgment Rule, supra* note 38, at 129.

[52] *See infra* Section III.A.

[53] *See infra* Part I.

[54] *See infra* Section IV.A.

[55] *See infra* Part IV.

[56] *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 601 n.268 (2003) [hereinafter *Director Primacy*]; *see also infra* Part III.

[57] *See infra* Part III.

Note that this debate—as exemplified in the positions described above on the GM directors' obligations—is mostly normative.[58] Scholars argue that directors should or should not take a certain course of action, and that corporate law should or should not make that course of action mandatory.[59] Importantly, this Article does not put forth a normative argument but a purely descriptive one: It argues that this is how fiduciary duties work in practice, without taking a position on how they should be.[60]

Of course, the economic and social concerns animating these positions have also led to debates regarding other corporate legal mechanisms to influence director conduct, like the proper incentive compensation for directors or whether employees (or other stakeholders) should be entitled to elect a slate of directors to represent their interests on the board.[61] These mechanisms raise a host of other concerns[62] and are thus outside the scope of this Article. For present purposes, this Article evaluates proposals to extend directors' fiduciary duties to stakeholders on the assumption—consistent with such proposals—that all other rules of corporate law remain unchanged, including the rule that shareholders alone vote to elect directors.[63]

Assuming the directors use a good process (no breach of the duty of care) and have no personal interest in the decision (no breach of the duty of loyalty), the vast majority of corporate actions will be reviewed under the business judgment rule.[64] The business judgment rule requires the court to ask only whether the directors had a good faith belief that their actions would benefit the corporation and its shareholders and, if so, bars the court from inquiring further.[65] And, as explained below, this is an incredibly

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58 *See supra* Introduction.

59 *See Director Primacy*, *supra* note 56, at 549–50.

60 *See infra* Part IV.

61 *See Director Primacy*, *supra* note 56, at 576, 605.

62 *See id.* at 576–77.

63 *See* Epstein, *supra* note 8 ("American corporate law provides that boards of directors are chosen solely by shareholders ...."); *see also infra* Section IV.B.

64 *See infra* Section III.A.

65 *See, e.g.*, *In re* Caremark Intern. Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996) ("[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through

low bar: For any corporate action that directly benefits a non-shareholder group, there are multiple plausible explanations for how this action redounds to the benefit of shareholders in the long run.[66] Because of this, directors rarely have trouble meeting the minimal requirements of the business judgment rule.[67]

Thus, while fiduciary duties remain an effective tool for preventing directors' improper pursuit of their own self-interests,[68] these duties have almost no impact on their decisions regarding the distribution of resources among various corporate constituencies.[69] As such, even if directors were to owe fiduciary duties to stakeholders like employees or customers, this would not protect them from the negative distributive effects of corporate decision-making, at least not without additional (and ill-advised) changes to corporate law.[70] Scholars who seek to secure increased power or protection for a given corporate constituency—whether shareholders, employees, or otherwise—would do well to focus their search on other legal mechanisms.[71]

Part I provides a brief overview of corporate fiduciary duties and recent scholarship discussing them.[72] Part II explains why the duty of loyalty is the most important fiduciary duty in the corporate social responsibility debate, explains a rarely noted difference between two distinct definitions of the duty of loyalty—one broad and one narrow—and argues that only the broader definition would allow this duty to have any impact on directors' distribution of corporate resources.[73] Part III argues that Delaware law, as a practical matter, enforces only the narrower definition

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'stupid' to 'egregious' or 'irrational', provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests .... Thus, the business judgment rule is process oriented and informed by a deep respect for all good faith board decisions.").

[66] *See infra* Part III.

[67] *See Director Primacy*, *supra* note 56, at 583 n.176; *see also infra* Section IV.B.

[68] *See Director Primacy*, *supra* note 56, at 603 n.281; *see also infra* Section III.C.

[69] *See Director Primacy*, *supra* note 56, at 588; *see also infra* Section IV.A.

[70] *See Director Primacy*, *supra* note 56, at 588; *see also infra* Section IV.B.

[71] *See infra* Section IV.C.

[72] *See infra* Part I.

[73] *See infra* Part II.

of loyalty due to the triggering conditions of its judicial standards of review.[74] Part IV explains how this largely eliminates shareholders' ability to effectively sue directors for decisions that favor other stakeholders at their expense.[75] It goes on to argue that, given this is true for shareholders, it would likewise be true for employees, customers, or any other stakeholders, were they to be owed fiduciary duties by directors.[76] The Article concludes, then, that the lively debate over to whom directors should owe fiduciary duties is not a debate worth having.[77]

I. FIGHTING OVER FIDUCIARY DUTIES

A. Corporate Fiduciary Duties: The Basics

Before getting into the argument, let's get a handle on the components of corporate decision-making. Scholars often describe the corporate form as a "nexus of contracts"—that is, a meeting place for the various contributors to production,[78] which this Article refers to as the corporation's "constituencies." Corporate law gives directors the primary responsibility for managing the business and affairs of the corporation,[79] such as overseeing the corporation's relationships with the constituencies involved.[80] Accordingly, as the following figure illustrates, while the various corporate constituencies absolutely depend on one another, they almost never deal with each other directly—that is, the shareholders would never reach out to the employees to negotiate how much money to spend on dividends versus bonuses.[81] Instead, each constituency (or its representatives) deal directly with the corporation (or representatives of the corporate legal entity), and the directors attempt to put the various inputs to their most effective uses.[82]

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[74] *See infra* Part III.
[75] *See infra* Part IV.
[76] *See infra* Part IV.
[77] *See infra* Section IV.C.
[78] *See Director Primacy*, *supra* note 56, at 552 n.31.
[79] DEL. CODE ANN. tit. 8, § 141(a) (West 2020).
[80] *See Director Primacy*, *supra* note 56, at 559–60.
[81] *See id.*
[82] *See id.* at 553–54.

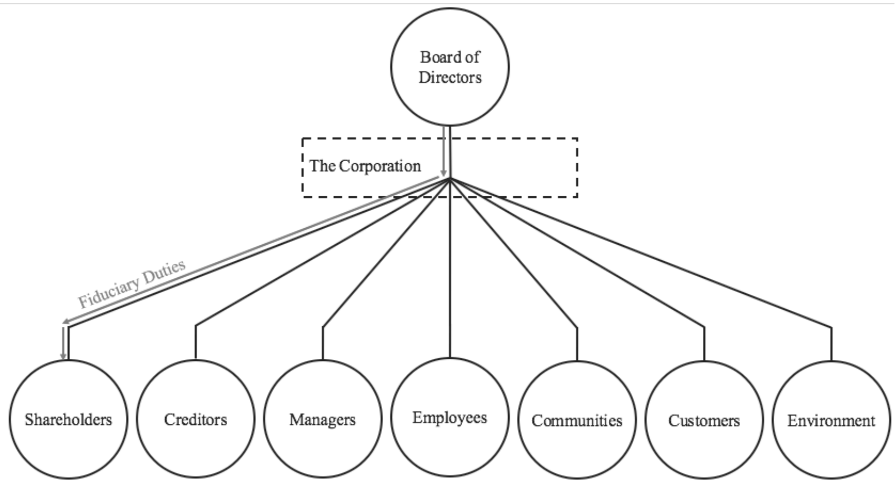

FIGURE 1: A NEXUS OF CONTRACTS

Shareholders contribute their equity capital, creditors contribute their debt capital, managers and employees contribute their expertise and labor, communities tend to contribute public goods like roads and utilities (as well as other intangibles), customers contribute revenue, and depending on the company, the environment may play a larger or smaller role.[83] Of course, paired with each contribution is a desired exchange.[84] In return, shareholders maintain equity ownership of the corporation and rights to any growth in its value; creditors have a contractual (i.e., superior to shareholders) right to repayment of their money on predetermined terms; managers and employees expect a salary; communities collect taxes and fees; and customers do not part with their money unless they believe the product they are buying is worth what they pay for it.[85] However, one important feature distinguishes the shareholders' relationship with the corporation from all the others: As the above figure shows, under current corporate law, shareholders are the only constituency for whom part of the exchange is that the directors owe them fiduciary duties.[86]

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[83] *See id.* at 552 n.31, 554.
[84] *See id.* at 553 n.36.
[85] *See id.* at 553 n.33, 564 n.81, 589, 597 n.245.
[86] *See supra* Figure 1.

It makes conceptual sense that shareholders enjoy the benefit of directors' fiduciary duties.[87] Shareholders do not legally "own" the corporation, but their equity ownership means they own the residual economic rights to it—that is, even though shareholders have no contractual right to demand repayment of their equity investment, their stock certificates are evidence of a legal interest in the value of the corporation as a whole, both when that value increases and decreases.[88] Those economic rights come with some limited means to control the business and affairs of the corporation, such as the right to vote for directors[89] or approve amendments to the certificate of incorporation,[90] but that is about where shareholder control ends. No doubt shareholders' right to elect directors (and thus to refuse to re-elect them) is an important restraint on director conduct.[91] But while particularly egregious or repeated misconduct is likely to result in a director being voted out by shareholders, this voting right does not give shareholders any direct say on directors' decisions regarding the day-to-day operations of the firm.[92]

Thus, corporate law often refers to this arrangement as the "separation of ownership and control,"[93] because while shareholders own the economic rights to the corporation, "the vast majority of corporate decisions are made by the board of directors alone, or by managers acting under delegated authority from the board of directors."[94]

The result looks just like the other relationships in which the law imposes fiduciary duties, where one party is left vulnerable to another's potential misconduct.[95] Think about the many

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[87] *See Director Primacy*, *supra* note 56, at 576.

[88] *See id.* at 565 and accompanying notes.

[89] DEL. CODE ANN. tit. 8, § 211(b) (West 2009).

[90] DEL. CODE ANN. tit. 8, § 242(b)(1)–(2) (West 2014).

[91] *See Director Primacy*, *supra* note 56, at 569–70 n.112.

[92] *See id.*

[93] Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) ("One of the fundamental tenets of Delaware corporate law provides for a separation of control and ownership .... An underlying premise for the imposition of fiduciary duties is a separation of legal control from beneficial ownership.").

[94] *Director Primacy*, *supra* note 56, at 559.

[95] *See id.* at 579–80 n.162.

ways directors could take advantage of the shareholders' equity contributions, given that shareholders have no right to demand repayment.[96] Directors could collect their paychecks but make decisions quickly and carelessly, allowing the shareholders' money to be wasted on poorly conceived ideas (likely a violation of the fiduciary duty of care).[97] Or they could use their corporate offices to enrich themselves personally, such as by making sweetheart deals with other businesses they own, or they could use their power to benefit third parties who have no connection to the shareholders, such as by donating all the corporation's money to charitable groups (likely violations of the duty of loyalty).[98]

While there is high-level agreement about which fiduciary duty (loyalty or care) prevents which types of director misconduct (as noted in the parentheticals in the above paragraph), little attention has been devoted to the duty of loyalty and the standard of review in the context of the corporate social responsibility debate.[99]

B. The Problem and Its Proposed Solutions

Legal scholars in various fields are no doubt aware of the role fiduciary duties play to protect shareholders from corporate directors taking undue advantage of them.[100] Hence, many have called attention to similar vulnerabilities among various stakeholders, and have proposed that directors should owe fiduciary duties to them as well.[101] But the dominant position in corporate legal scholarship has steadfastly rejected all such proposals.[102] This Section provides a brief overview of this debate to illustrate what is believed to be at stake;[103] however, the rest of this Article argues that scholars on both sides of this debate have misunderstood the legal protection that comes with being owed directors' fiduciary

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[96] *See id.* at 581–82.
[97] *See id.*
[98] *See id.*
[99] *See id.* at 579–80 n.162; *see also id.* at 562. n.74.
[100] *See Director Primacy*, *supra* note 56, at 593 n.221.
[101] *See, e.g.*, Greenfield, *supra* note 3, at 975.
[102] *See Director Primacy*, *supra* note 56, at 563.
[103] *See infra* Section I.B.

duties, and as a result have seriously overestimated the importance of fiduciary duties for corporate social responsibility.[104]

The amount of legal and economic scholarship positing that boards of directors ought to run corporations for the exclusive benefit of shareholders is, quite frankly, overwhelming.[105] For many legal scholars, this is a normative economic view that translates naturally into the normative legal position that directors ought to owe fiduciary duties to the shareholders alone.[106] Many arguments have been put forth to justify this view, but the two that stand out are the agency-cost argument and the social-welfare argument.[107] For the first, directors are seen as the shareholders' agents, who have been engaged to do the shareholders' bidding but impose "costs" any time they fail to act in the shareholders' interest.[108] As such, a norm that requires them to do so is appropriate.[109] Second, the social-welfare argument posits that compliance with this norm is best not just for shareholders but for all stakeholders as well, and thus for the welfare of society as a whole.[110] When directors maximize shareholder wealth, the argument goes, this ensures corporations do what they do best—namely, increase the wealth of all their participants, which in turn will increase the wealth of society in general.[111]

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[104] *See infra* Parts II, III, IV.

[105] *See Director Primacy*, *supra* note 56, at 563.

[106] *See* Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1190–92 (2002).

[107] *See* Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimating Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1, 51 (2004); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991).

[108] For an overview of agency-cost theory, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 308–09 (1976).

[109] *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 107, at 92. *But see* Stout, *supra* note 106, at 1200–01 (arguing that while the shareholders' agency cost is the least bad reason to adopt a norm of shareholder wealth maximization, there are a number of other costs and benefits that "ultimately cannot be answered *except on the basis of empirical evidence*.").

[110] *See* EASTERBROOK & FISCHEL, *supra* note 107, at 38.

[111] *See, e.g.*, *id.* at 38; Chen & Hanson, *supra* note 107, at 47; WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 287–88 (2003) ("[F]raming the board's mission as

But stakeholders cannot leave well enough alone.[112] They—or, at least, a set of scholars and politicians on their behalf—also want the protection of directors' fiduciary duties.[113] Over thirty American states (with Delaware a notable exception) have passed so-called "Nonshareholder Constituency Statutes" that permit (or in some cases, require) corporate directors to take into account the interests of constituencies other than the shareholders when making corporate decisions.[114] Scholars have gone so far as to argue that such statutes should constitute an extension of the directors' fiduciary duties and thus should be interpreted as creating a "duty not to harm" stakeholders, which would in turn permit "direct legal action against the board by members of constituent groups to enforce" this duty.[115]

In addition, many scholars have argued that recent Supreme Court decisions like *Citizens United v. Federal Election Commission*[116] and *Burwell v. Hobby Lobby Stores*[117] represent a shift in corporate theory that places an unrealistic burden on state corporate law to protect the interests of stakeholders.[118] These developments have prompted many responses, including from the prominent corporate jurist Leo Strine and his co-author Nicholas Walter, who concluded that such decisions strengthen

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maximizing shareholder welfare also serves to maximize the welfare of other corporate constituencies and society as a whole."); Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 261 n.45 (1989) ("[M]aximizing gains to target shareholders serves the broader objectives of shareholder and social welfare.").

[112] *See* Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 30 (1996).

[113] *See id.*

[114] *See* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973, 1989 (2009); *see also* 7 R.I. GEN. LAWS ANN. § 7-5.2-8(a)(1)–(2) (West 1990).

[115] Mitchell, *supra* note 6, at 585.

[116] *See* 558 U.S. 310, 365 (2010) (holding that the First Amendment prohibits the government from restricting independent expenditures for communications by corporations, labor unions, and other associations).

[117] *See* 573 U.S. 682, 689–91 (2014) (holding that closely held for-profit corporations are exempt from a generally applicable regulation its owners religiously object to when there is a less restrictive means of furthering the law's interest, according to the provisions of the Religious Freedom Restoration Act).

[118] *See* Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 642–43 (2016).

the "argument that corporations should have to consider the best interests of all corporate constituencies and societies as a whole when making decisions."[119] Others, like David Yosifon, responded even more strongly, advancing the normative argument that the law should "make directors fiduciaries of workers and consumers ... because contract is insufficient to protect consumer interests and because the backstop of government regulation is implausible under shareholder primacy," and thus "directors must consider it their [fiduciary] duty to 'work hard and honestly' not only to advance shareholder interests, but worker and consumer interests as well."[120]

In a similar vein, many have argued that the amount of fiduciary protection offered to corporate constituencies should vary depending on a constituency's representation in the firm's corporate governance or contribution to the firm.[121] For example, Matthew Bodie has argued that "employers are fiduciaries [to employees] and must refrain from opportunism, especially when employees have no voice in governance. However, in an organizational setting where employees genuinely participate in governing the firm, the parties' reciprocal fiduciary duties should be recalibrated to require a balanced set of obligations."[122] And Kent Greenfield has argued that corporations' potential for "breaches of the public trust or the imposition of costly externalities on stakeholders or communities" justifies the conclusion that "directors should be held to a fiduciary obligation to all of the firm's stakeholders that varies

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[119] Strine & Walter, *supra* note 1, at 390. The authors provide an insightful analysis on the tension between the *Citizens United* decision and what they call "conservative corporate theory." *Id.* While their article does not focus on policy recommendations, it seems that they nonetheless believe that directors' consideration of nonshareholder constituencies should be a right, not a duty: "If the for-profit corporation really is a citizen like any other, and a distinct one from that of any of its constituencies, including its stockholders, then its board *must be entitled to have it act* as a patriotic, moral citizen imbued with a conscience." *Id.* (emphasis added).

[120] *The Public Choice Problem*, *supra* note 17, at 1236.

[121] *See* Bodie, *supra* note 2, at 862.

[122] Bodie, *supra* note 2, at 819; *see also* Pollman, *supra* note 118, at 689 ("Because state corporate law does not include employees within the governance framework, give them a voice in the corporation, or protect their interests, it is particularly important that *external employee-protective laws be given effect*." (emphasis added)).

according to the nature of the stakeholders' contributions to the success of the firm."[123] Still others have focused on the effects that corporate activity has on employees in the era of globalization and made normative arguments that corporate directors should owe employees fiduciary duties that include specific prescriptive obligations: "Directors [sh]ould owe fiduciary obligations to employees, including the duty to provide information and consult with them about strategic decisions that affect job security and working conditions."[124]

In sum, scholars in both the pro-shareholder and pro-stakeholder camps disagree widely, on a normative level, about *to whom* corporate directors *should* owe fiduciary duties.[125] But they almost all agree on a descriptive level: that fiduciary duties play a meaningful role in determining how directors distribute resources to each corporate constituency, given that those who are owed fiduciary duties have the power to sue directors to block distributive decisions they find unfair.[126] This Article now turns to argue the contrary.

II. A CLOSER LOOK AT FIDUCIARY DUTIES

Discussions of fiduciary duties tend to lead with the comment that fiduciary law has eluded precise elaboration, so this discussion will be no exception.[127] Indeed, for several years, a

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[123] Greenfield, *supra* note 3, at 947, 949, 975–76.

[124] Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 901, 904 (1993).

[125] *Compare id.* at 902, *with* EASTERBROOK & FISCHEL, *supra* note 107, at 38.

[126] *See, e.g.*, O'Connor, *supra* note 124, at 902, 950, 955, 958–59; *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006).

[127] *See, e.g.*, MATTHEW CONAGLEN, FIDUCIARY LOYALTY: PROTECTING THE DUE PERFORMANCE OF NON-FIDUCIARY DUTIES 1 (2010) ("The word 'fiduciary' recurs frequently in legal discussion, but the understanding of the meaning of the word remains very confused."); Paul B. Miller, *A Theory of Fiduciary Liability*, 56 MCGILL L.J. 235, 237 (2011) (calling the law of fiduciaries "unusually vexing"); Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1045 (1991) ("Fiduciary relationships have occupied a significant body of Anglo-American law and jurisprudence for over 250 years, yet the precise nature of the fiduciary relationship remains a source of confusion and dispute."); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399,

leading viewpoint was that fiduciary relationships were indefinable.[128] However, in recent decades several scholars have hit general fiduciary law with systematic treatments, formulating both descriptive and normative accounts of the fiduciary obligation to cast it as a coherent whole, or at least to find within it a coherent thread.[129] While this Article is greatly indebted to those projects, it does not provide a systematic elaboration. Instead, it focuses on the narrow question of how effectively shareholders (or anyone conceivably owed a fiduciary duty) can rely on these duties to protect themselves from directors' decisions that favor other corporate stakeholders at their expense.[130]

A. Which Fiduciary Duty Are We Talking About?

There is widespread agreement among scholars that directors' fiduciary duties to shareholders function to secure the shareholder wealth maximization norm of corporate conduct—even among those who reject this norm as a matter of policy.[131]

1400 (2002) (opening his essay by stating that "[f]iduciary law is messy"); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1736 (2001) [hereinafter Blair & Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*] (calling fiduciary duty an "elusive legal concept").

[128] *See* L. S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 73 (1962) ("The word 'fiduciary,' we find, is *not* definitive of a single class of relationships to which a fixed set of rules and principles apply. Each equitable remedy is available only in a limited number of fiduciary situations."); PAUL FINN, FIDUCIARY OBLIGATIONS 1 (40th Anniversary ed. 2016) ("As with many of the general doctrines and remedies of Equity, the legacy of this neglect of 'fiduciaries' and of 'fiduciary duties' has been doubt and confusion ... [T]he term 'fiduciary' is itself one of the most ill-defined, if not altogether misleading terms in our law."). For a brief summary of this idea's influence on the scholarship on fiduciary law, see Paul B. Miller, *The Fiduciary Relationship*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 237 (Andrew S. Gold & Paul B. Miller eds., 2014) [hereinafter *Fiduciary Relationship*].

[129] *See* Andrew S. Gold & Paul B. Miller, CONTRACT, STATUS, AND FIDUCIARY LAW 1, 3 (2016); *Fiduciary Relationship*, *supra* note 128, at 267–69; Smith, *supra* note 127, at 1400; Miller, *supra* note 127, at 239; CONAGLEN, *supra* note 127, at i, 1; Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993).

[130] *See infra* Part IV.

[131] Alces, *supra* note 15, at 247. A notable exception is the work of Margaret Blair and Lynn Stout, which has argued that current corporate law actually

But the precise way in which corporate fiduciary duties might fulfill this function has received rather limited scholarly attention.[132] This Article fills that gap and, in so doing, concludes that much of this scholarly agreement is unfounded.[133]

To put a finer point on it, let us ask a question. If you were a shareholder of General Motors who wanted to prevent your elected directors from distributing surplus corporate wealth to GM employees, which fiduciary duty would you use to crack the whip?[134] This question is not about strategic litigation decisions like which standard of review applies or whether directors are likely to be exempt from monetary damages for violating certain duties. Rather, it is intended as a basic 1L issue-spotter exam question: Which legal rule—in particular, which fiduciary duty—applies to this precise type of director misconduct? In Delaware, there are two of them: the duty of care and the duty of loyalty.[135] How would each of them would square up?

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does *not* require directors to pursue shareholder wealth maximization. *But see* Blair & Stout, *A Team Production Theory of Corporate Law*, *supra* note 27, at 248–51.

[132] *See, e.g.*, *id.* at 248–49.

[133] *See infra* Conclusion.

[134] Of course, any seasoned scholar or practitioner of corporate law understands that a decision like this one is, in practice, beyond the reach of shareholders to prevent. *See, e.g.*, Peter A. Atkins et al., *Putting to Rest the Debate Between Corporate Social Responsibility and Current Corporate Law*, SKADDEN (Aug. 27, 2019), https://www.skadden.com/insights/publications/2019/08/putting-to-rest-the-debate [https://perma.cc/39XM-XDPT] (stating that "the shareholder primacy rule, which governs Delaware corporations ... has sufficient room to accommodate socially responsible corporate expenditures—including those aimed at addressing the interests of nonshareholder stakeholders—determined in the lawful exercise of a board's business judgment"). Nonetheless, scholars have consistently insisted that Delaware directors' fiduciary duties to shareholders protect shareholders from directors' undue favoritism towards stakeholders. The point of this hypothetical is to test that claim: if shareholders really can compel directors to exclude the interests of all other stakeholders, which aspect of directors' fiduciary duties so requires them to do so?

The flip side of this, as argued below, is equally important to scholars on the "pro-stakeholder" side of the corporate social responsibility debate. If the fiduciary duties that corporate directors owe to their shareholders do not have the power to prevent decisions that are unfavorable to shareholders, it would do little good for other stakeholder groups to secure a change in the law in which the directors also owe a fiduciary duty to them.

[135] Stone e*x rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 367, 369–70 (Del. 2006) (referencing Cede & Co. v. Technicolor, Inc., 634 A.2d 345,

The duty of care, for its part, requires corporate directors to act carefully and on an informed basis.[136] Note that these are not substantive requirements.[137] That is because in Delaware there is no substantive duty of care: "Due care in the decision-making context is *process* due care only."[138] This means that when directors make decisions after careful deliberation of all material information that is reasonably available, they have met the standard of conduct, and the standard of review by which Delaware courts will evaluate their conduct is the business judgment rule.[139] This is Delaware's most deferential standard of review, as explained in the next Part, under which their "decisions will not be disturbed [by the court] if they can be attributed to any rational business purpose."[140]

Even without the business judgment rule's application, though, the duty of care would be of little use to the GM shareholders who wish to prevent the payment of employee bonuses.[141] So long as the directors' decision to pay bonuses is made with all

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361 (Del. 1993)). While older Delaware decisions have treated the duty of good faith as an independent fiduciary duty, *Stone v. Ritter* clarified that:

> [A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, 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.

Id. at 370; *see also In re* Walt Disney Co., 906 A.2d at 52, 64, 66. Under Delaware law, violations of good faith include acting with "an actual intent to do harm" to the corporation, and a failure to act which amounts to an "intentional dereliction of duty, a conscious disregard for one's responsibilities.*" Id.* So long as the decision to pay bonuses is made with the best interests of the corporation in mind—say, to promote employee welfare and morale, and thereby increase productivity—there can be no argument that it was made in bad faith. Because of this, the duty of good faith is not a promising route for shareholders to interfere with corporate directors' decisions to distribute wealth within the corporation.

[136] *See, e.g.*, *In re* Walt Disney Co., 906 A.2d at 64.

[137] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

[138] *Id.* at 264 ("As for the plaintiffs' contention that the directors failed to exercise 'substantive due care,' we should note that such a concept is foreign to the business judgment rule. Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context.").

[139] *See id.* at 254–55, 257, 259.

[140] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); *see also infra* Section III.A.

[141] *See infra* Section II.A.

due care and consideration—e.g., by reviewing projections of productivity increases, considering the various ways the funds might be used—the duty of care is satisfied.[142] The obligation to take care contains no implicit requirement to orient that care toward a specified end, such as maximizing wealth for the shareholders.[143]

To put it another way, the duty of care is completely "agnostic" about who must benefit from such care.[144] The duty of care thus helps maximize shareholder wealth by preventing losses from various types of carelessness and negligence—say, by rushing through a decision without evaluating all the potential consequences it may produce.[145] But it does not include any requirement that shareholders are the primary beneficiary of such care, let alone that they can litigate on directors' duty of care to prevent the payment of employee bonuses.[146] In short, this obligation is inapposite to directors' distributive decisions that are made carefully and deliberately, whether or not they favor shareholders.[147]

If shareholders want to block the employee bonuses, then, their only chance is to rely on the duty of loyalty.[148] The standard of conduct for corporate directors who owe a duty of loyalty to shareholders is conceptually simple.[149] Corporate directors must act for the "exclusive benefit" of the shareholders, such that they are required to make every decision with the singular goal of maximizing shareholder wealth.[150] Understood in this way, a director violates the duty of loyalty not only when she acts in her own self-interest, but also when she acts in the interest of any nonshareholder group—even if she has no personal interest in that group's benefit.[151] As such, this formulation of the duty of loyalty (if Delaware courts were actually to enforce it this way) is a perfect

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142 *See, e.g.*, *Brehm*, 746 A.2d at 264.

143 *See id.* at 264.

144 *See Sinclair Oil Corp*., 280 A.2d at 720 (Del. 1971).

145 *See, e.g.*, McMullin v. Beran, 765 A.2d 910, 922 (Del. 2000) ("[B]oards that have 'failed to exercise due care are frequently boards that have been rushed.'").

146 *See* DEL. CODE ANN. tit. 8, § 251(b) (2020); *see also Brehm*, 746 A.2d at 264.

147 *See, e.g.*, *McMullin*, 765 A.2d at 921.

148 *See* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1108 (1988).

149 *See id.*

150 *See id.*

151 *See id.*

match for the GM shareholders' employee bonuses problem.[152] If the directors distribute the surplus funds to the employees (or any other stakeholder), a colorable argument can be made that they have not acted for the "exclusive benefit" of shareholders, have thus violated their fiduciary duty of loyalty to shareholders, and are subject to liability for doing so.[153]

The only problem with this is that—thanks to the standard of review—the version of the duty of loyalty that is actually enforced by Delaware courts is narrower than this standard of conduct suggests.[154]

B. Two Definitions of Loyalty

So far, this Article has singled out the duty of loyalty as the sole fiduciary duty with any potential to govern board decisions that distribute wealth within a corporation.[155] This Section takes a closer look at the duty of loyalty so as to test how successfully it might be employed toward this end by shareholders.[156] It explains that courts and scholars have advanced two distinct

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[152] *See id.*

[153] *See id.*

[154] *See infra* Part III.

[155] The duty of loyalty's importance in corporate law comports with its centrality in fiduciary law generally, where scholars have described it as *the* distinctive fiduciary duty. *See, e.g.*, *Fiduciary Relationship*, *supra* note 128, at 1 ("There is little doubt that fiduciary relationships generate at least one distinctive legal duty, the duty of loyalty."); UNIF. TR. CODE § 802, cmt. 1 (Nat'l Conf. Comm'rs on Unif. L. 2010) (stating that the duty of loyalty is "perhaps the most fundamental duty of the trustee"); Gregory S. Alexander, *Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 776 (1999) ("Unlike the contractual relationship, undivided loyalty is the heart of the fiduciary relationship, especially for property fiduciaries like trustees and estate executors."); CONAGLEN, *supra* note 127, at 1 (citing *Mothew* and stating that "[t]he concept of loyalty is now well established as the core—indeed the defining—concept of fiduciary doctrine"); J.C. SHEPHERD, THE LAW OF FIDUCIARIES 48 (Carswell Co. Ltd. ed., 1981) ("[T]he terms fiduciary duty and duty of loyalty are so much co-extensive as to be, in effect, alternate descriptions of the same thing."). Some scholars even go so far as to argue it is the only duty that is properly called a fiduciary one. *See, e.g.*, D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1400–11 (2002); FINN, *supra* note 128, at 330–32; FRANKEL, *supra* note 33, at 129.

[156] *See infra* Section II.B.

definitions of the duty of loyalty—one broad and one narrow—and from this, only the broad definition of loyalty would allow shareholders to prevent directors from favoring nonshareholder constituencies at their expense.[157] This matters because, as explained in the next Part, only duty of loyalty claims that fit within the narrow definition are evaluated under a more demanding standard of review.[158]

To begin, it is helpful to distinguish between two different types of disloyal conduct by directors: actions that are (a) self-interested, in that they elevate the director's interests over shareholders' interests, and actions that are (b) stakeholder-interested, in that they elevate the interests of a nonshareholder constituency (like employees or customers) over shareholders' interests.[159] With this distinction in mind, it is easier to see the difference between the two definitions of the duty of loyalty that repeatedly show up in legal scholarship, for which the following terms are used as shorthand:

1. *Exclusive Benefit*: Directors must act always for the "exclusive benefit" of shareholders.[160] *Result*: Directors may not act in their own interests or in the interests of others—including stakeholders like employees, creditors, customers, or communities.[161]
2. *Disinterestedness*: Directors must not act for their own benefit at the expense of the corporation or its shareholders.[162] *Result*: Directors may not act to

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[157] *See infra* Section II.B

[158] *See infra* Part III.

[159] *See* Smith, *supra* 127, at 1440; *see also* Blair & Stout, *A Team Production Theory of Corporate Law*, *supra* note 27, at 289.

[160] *See, e.g.*, Macey, *supra* note 24, at 23 ("Directors and officers are legally required to manage a corporation for the exclusive benefit of its shareholders, and protection for other sorts of claimants exists only to the extent provided by contract.").

[161] *See* Fischel & Langbein, *supra* note 148, at 1108.

[162] *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (describing the judicial inquiry into "the independence and *disinterestedness* of the directors") (emphasis added)); *see also* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("The rule that requires an undivided and unselfish loyalty to the corporation demands

> benefit their own interests, but they may act to benefit the interests of others, including stakeholders.[163]

Outside of discussions concerning corporate social responsibility, the difference between these two definitions of loyalty may be insignificant: In most fiduciary relationships, the inherent risk is that the fiduciary has the (tautological) incentive to act in her own self-interest, not that she might use her position to improperly benefit a third party she has absolutely no relationship with and no legal duty to serve.[164] Maybe that is why it is commonplace for scholars to treat these two definitions of the duty of loyalty as completely interchangeable.[165] But in the corporate social responsibility debate, this minor difference has incredible importance.[166]

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that there shall be no conflict between duty and self-interest."); MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 250 (1995) ("The essence of a loyalty violation is that directors have subverted the decision-making process to benefit themselves or some party to whom they are beholden (such as a controlling shareholder) and that the benefit has come at the expense of the corporation or its shareholders.").

[163] *See* ABA Committee on Corporate Laws, *Corporate Director's Guidebook*, 49 BUS. LAW. 1243, 1254–55 (1994).

[164] *See* Fischel & Langbein, *supra* note 148, at 1119 ("[T]he risk always exists that the trustee of an employee benefit plan will take self-interested action (for example, siphoning assets from the pension fund) that will operate to the detriment of the beneficiaries (employers and employees).").

[165] *See, e.g.*, Bodie, *supra* note 2, at 826 ("In particular, agents have the duty of loyalty to the principal—the duty to 'act *solely for the benefit* of the principal in all matters connected with his agency.' This *self-abnegation* is a critical aspect of the agency relationship, because it balances out the agent's power to step into the shoes of the principal and act *on the principal's behalf*." (emphases added)); Blair & Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, *supra* note 127, at 1782–83 ([T]he keystone of the fiduciary relationship lies in the fiduciary's commitment to abandon self-interest and promote her beneficiary's welfare instead of her own."); ABA Committee on Corporate Laws, *supra* note 163, at 1254–55 ("The duty of loyalty requires directors to exercise their powers *in the interests of the corporation* and not in the directors' *own interest or in the interest of another person* (including a family member) or organization. Simply put, directors should not use their corporate position to make a *personal profit* or gain or for other *personal advantage*." (emphases added)); EASTERBROOK & FISCHEL, *supra* note 107, at 103 (defining the duty of loyalty as an obligation "to maximize the investors' wealth rather than one's own").

[166] *See infra* Section II.C.

Perhaps the best way to demonstrate this is by spatial representation. In the following figure, each definition is represented by a circle, and inside that circle is a description of the types actions that are prohibited by that definition.[167] Each circle is inclusive of all within it, including other circles (if any).[168]

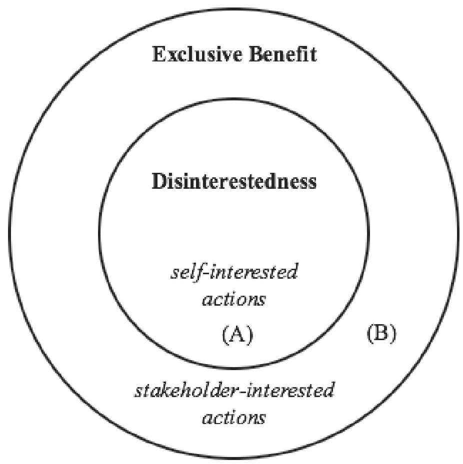

FIGURE 2: WHAT IS PROHIBITED BY EACH DEFINITION OF LOYALTY

As seen above, the exclusive benefit definition contains the disinterestedness definition.[169] Accordingly, the exclusive benefit definition prohibits all the actions described within its circle: both actions that benefit nonshareholder constituencies (stakeholder-interested actions) and actions that benefit the director (self-interested actions).[170] The disinterestedness definition, for its part, is the narrower of the two, as it prohibits only those actions that benefit the director.[171] Put another way, a definition of disinterestedness fails to expressly prohibit the fiduciary from taking stakeholder interested actions.[172]

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[167] *See infra* Figure 2.
[168] *See id.*
[169] *See supra* Figure 2.
[170] *See id.*
[171] *See id.*; *see also* DOOLEY, *supra* note 162, at 250.
[172] *See supra* Figure 2; *see also* DOOLEY, *supra* note 162, at 250.

It is worth clarifying at this point that these definitions describe the purpose of any corporate action, and not the means of bringing it about or the result that it produces.[173] Even strict advocates of what I am calling exclusive benefit agree that directors can cause the corporation to enter contracts with employees or customers that are beneficial to both parties.[174] But these two definitions diverge on whether maximizing shareholder wealth must be the directors' exclusive goal, or whether directors are required merely to avoid transactions in which their own self-enrichment is a goal.[175]

While the definitions of disinterestedness and exclusive benefit overlap in terms of some covered conduct, they are not perfectly coextensive.[176] Again, this all reeks of abstraction, so let's get concrete. Imagine a GM director who takes two different actions: (A) causes GM to enter a ten-year contract with a supplier that she, the director, also happens to own a controlling interest in, on terms that are much better than the supplier could otherwise get on the market ("sweetheart self-dealing"); and (B) pays bonuses to GM employees across the board at a much higher level than comparable companies would pay ("outrageous employee bonuses"). These actions are mapped on Figure 2 above.

Accordingly, it can be seen that action (A), the sweetheart self-dealing, violates both exclusive benefit (in that it was not done for the exclusive benefit of the shareholders) and disinterestedness (in that it was done for the director's own benefit).[177] By contrast, action (B), the outrageous employee bonuses, violates only the principle of exclusive benefit, in that it was not done for the shareholders' exclusive benefit.[178] Action (B) does not violate the principle of disinterestedness because it was not done for the director's own benefit.[179]

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[173] *See supra* Section II.B.

[174] *See* Fischel & Langbein, *supra* note 148, at 1119 ("Moreover, because the employer and the employees continually monitor the performance of the trustee of an employee benefit plan, there may be less need for strict fiduciary duties that limit the discretion of the trustee to engage in conduct that may be mutually beneficial to both groups.").

[175] *See supra* Section II.B.

[176] *See id.*

[177] *See supra* Figure 2.

[178] *See id.*

[179] *See id.*

C. Stakeholder-Interested Conduct

Here is why this difference matters. Obviously, directors funneling corporate resources into their own pockets is undesirable to shareholders and stakeholders alike, and thus has never been an issue of much concern in the corporate social responsibility debate.[180] So, the enforcement of disinterestedness is important, but uncontroversial and irrelevant to the issue at hand.[181] Instead, what matters in the corporate social responsibility debate is how directors distribute corporate resources among everyone else, and the corresponding rights of corporate constituencies to challenge those decisions when they find them unfair.[182] And unless the duty of loyalty is enforced in its broader definition—exclusive benefit—it will have no relevance to distributive decisions at all.[183]

For shareholders to effectively challenge directors' stakeholder interested conduct on a theory of a violation of fiduciary duty, Delaware law must enforce the broader principle of exclusive benefit.[184] Otherwise—if the duty of loyalty were enforced merely as disinterestedness—directors could not be punished for providing benefits to employees or customers at the shareholders' expense.[185] But, as the following Part explains, in shareholder plaintiff suits against corporate directors, the standard of review in Delaware courts results in the enforcement of only the narrow definition of the duty of loyalty.[186]

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[180] *See* Guth v. Loft Inc., 5 A.2d 503, 510 (Del. 1939).

[181] *See id.*

[182] *See, e.g.*, Macey, *supra* note 24, at 23 ("Directors and officers are legally required to manage a corporation for the exclusive benefit of its shareholders, and protection for other sorts of claimants exists only to the extent provided by contract.").

[183] *See supra* Section II.B. To put it another way, the entire focus of the corporate social responsibility debate concerns director conduct that falls in the outer ring of Figure 2—a director's actions that seek to benefit stakeholders but do not benefit the director herself. *See supra* Figure 2. Such stakeholder-interested conduct includes all corporate transactions in which a director does not have a material self-interest (beyond her role as a director) and with which she provides a benefit for a nonshareholder corporate constituency like employees or customers. *See supra* Section II.B.

[184] *See, e.g.*, Fischel & Langbein, *supra* note 148, at 1108.

[185] *See supra* Section II.B.

[186] *See infra* Part III.

III. FIDUCIARY DUTIES AND THE STANDARD OF REVIEW

Debates about fiduciary duties in the context of corporate social responsibility are based on the shared descriptive premise that shareholders currently have the legal power to root out stakeholder interested conduct by holding directors accountable to the exclusive benefit principle.[187] But, as this Article argues next, this descriptive premise is mistaken.[188] The reason for this is because of the enormous difference in Delaware corporate law between the standard of conduct governing corporate directors' behavior and the standard of review with which a Delaware court will evaluate such conduct and determine whether to impose liability or grant relief.[189] To be clear, this Article does not dispute that exclusive benefit is the standard of conduct that Delaware directors are required to follow.[190] Instead, this Article shows that the standard of review for shareholder claims of directors' fiduciary violations remains the default rule of absolute deference to directors, except in rare circumstances.[191] For all practical purposes, then, this limits the duty of loyalty in Delaware to the principle of disinterestedness.[192]

The vast difference between the standard of conduct and standard of review in Delaware has received much attention from scholars and courts,[193] but there has yet to be a thorough explanation of the implications of this disparity for the fight over fiduciary duties—a gap this Article fills.[194] For example, the Supreme Court of Delaware has not been shy in admitting that "[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting,

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[187] *See* FRANKEL, *supra* note 33, at 124–25.

[188] *See infra* Section III.A.

[189] *See* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 438 (1993) ("In the real world ... the standards of review in corporate law pervasively diverge from the standards of conduct.").

[190] *In Defense of the Shareholder*, *supra* note 10, at 1424 ("As it has long done, Delaware law still requires directors to put shareholder interests ahead of those of nonshareholders.").

[191] *See* Eisenberg, *supra* note 189, at 442–43.

[192] *See id.* at 452.

[193] *See id.* at 438, 442–43.

[194] *See supra* note 133 and accompanying text.

the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation."[195] As explained below, courts and scholars have provided various rationales in support of each applicable standard of review: the business judgment rule, enhanced scrutiny, and entire fairness.[196] And, importantly, the business judgment rule applies in all but highly unusual circumstances.[197]

In general, there are not a lot of corporate law cases, in Delaware or elsewhere, involving directors who have given away corporate resources to employees or customers simply because they believed there were moral or charitable reasons for doing so.[198] To the contrary, when directors attempt to justify their decisions with regard to nonshareholder interests, courts are much more likely to see through those attempts as pretext for self-interest.[199] Obviously, it is little more than a tautology to say that directors are likely to act in their own self-interest.[200] Conversely, it is not surprising that very few directors would choose to direct resources to nonshareholders in cases where they have no self-interest in doing so, and furthermore have a legal duty not to do so.[201] It should not be surprising, then, that cases involving stakeholder-interested conduct—when done for the sole purpose of enriching stakeholders—are few and far between.[202]

Of course, this is precisely why pro-stakeholder theorists have argued that directors should owe fiduciary duties to nonshareholders: to give directors the proper incentives to protect the interests of constituencies that are particularly vulnerable.[203] Yet, the point of this Article is that even if the law were to impose on

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[195] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989) (quoting AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986)).

[196] Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011) ("Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.").

[197] *See* Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 998 (2002) [hereinafter *Interpreting Nonshareholder*].

[198] *See In Defense of the Shareholder*, *supra* note 10, at 1424, 1427–28.

[199] *See* Eisenberg, *supra* note 189, at 453.

[200] *See In Defense of the Shareholder*, *supra* note 10, at 1445.

[201] *See id.* at 1424, 1427–28.

[202] *See id.*

[203] *See Business Judgment Rule*, *supra* note 38, at 93–94.

directors a fiduciary duty to nonshareholder groups, like employees, whatever vulnerabilities that currently exist would continue without remediation.[204]

A. The Duty of Loyalty and the Business Judgment Rule

The ultimate culprit for why Delaware shareholders cannot hold directors to an exclusive benefit principle is the business judgment rule.[205] Despite the widespread agreement that Delaware law requires corporate directors to pursue the exclusive benefit of shareholders,[206] it is no secret that Delaware courts nonetheless tolerate almost all director decisions that favor nonshareholder constituencies—or what this Article calls stakeholder interested conduct—even when they appear to do so at shareholders' expense.[207] To explain this tolerance, scholars routinely point to the standard of review in Delaware that is both the default rule and the most deferential to corporate directors, the so-called business judgment rule.[208] But no scholar has yet addressed how this deferential standard of review impacts the fight over fiduciary duties in the corporate social responsibility debate.[209]

In its simplest formulation, the business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[210] This is "Delaware's default standard of review" that applies when a shareholder plaintiff sues directors to challenge a decision directors have made.[211] To rebut the business judgment rule's presumption, the plaintiffs' complaint:

> must support a reasonable inference that in making the challenged decision, the board of directors breached either its duty of loyalty or its duty of care. If the plaintiff fails to satisfy that

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[204] *See supra* note 138 and accompanying text.
[205] *See* Eisenberg, *supra* note 189, at 441, 443.
[206] *See In Defense of the Shareholder*, *supra* note 10, at 1424.
[207] *See* Alces, *supra* note 15, at 246, 248.
[208] *See* Eisenberg, *supra* note 189, at 441, 443.
[209] *See id.* at 437–38.
[210] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).
[211] *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013).

> burden, a court will not substitute its judgment for that of the board if the decision can be attributed to any rational business purpose.[212]

In short, Delaware courts refuse to scrutinize the substance of a corporate decision unless the shareholder plaintiff adequately alleges that the decision-making directors violated one of their fiduciary duties.[213]

In such cases, the business judgment rule applies.[214] Assuming the directors were disinterested and exercised due care in reaching a decision, as this Article has throughout, the remainder of the rule requires that the court determine whether the decision was made in good faith.[215] And because the burden of proof rests with the shareholder plaintiffs (as in any litigation), the directors' decision will not be overturned unless the shareholders can establish that the director acted in bad faith.[216] However, as the following Part explains, this task is exceedingly difficult for shareholders due to the nature of corporate decision-making.[217] That is, for every action that can be characterized as stakeholder interested, there are several plausible explanations for how that action will likely redound to the benefit of shareholders in the long run.[218] As a result, the number of instances in which it can be established that directors did not have a good faith belief that

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[212] Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009) (footnotes and internal quotations omitted).

[213] *Id.* at 705–06.

[214] *Id.*

[215] *See, e.g.*, *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036, at *13 (Del. Ch. 1989) ("The business judgment form of judicial review encompasses three elements: a threshold review of the objective financial interests of the board whose decision is under attack (*i.e.*, independence), a review of the board's subjective motivation (*i.e.*, good faith), and an objective review of the process by which it reached the decision under review (*i.e.*, due care).") (citations omitted).

[216] *Id.* ("If [the] plaintiff cannot show a prima facie case of, or, if such a case is made out, the balance of the evidence does not establish, bad faith or gross negligence[,] then there is, in my opinion, no basis to issue an injunction or to impose liability.").

[217] *Id.* at 1156–58.

[218] *See Interpreting Nonshareholder*, *supra* note 197, at 999–1000; *see also supra* Section IV.A.

their actions would ultimately redound to the benefit of shareholders is vanishingly small.[219]

The reasons behind the rule are motivated not by concerns about corporate social responsibility, but rather by something more foundational to corporate law: the balance between director authority and accountability.[220] "Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in 8 Del.C. § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors."[221] As such, "[t]he business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors."[222] Conceptually speaking, if the Court of Chancery could overrule every corporate decision no matter how small or inconsequential, then it would not be directors who have the ultimate authority over the business and affairs of a Delaware corporation, but instead Delaware judges.[223] The business judgment rule therefore reflects the rather sensible policy that judges—who do not have the experience, knowledge, and expertise of corporate management—should not override the decisions of those who do.[224] One court put it well:

> The rule was developed to protect directors' judgments on questions of corporate governance. Questions like "should we buy a

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[219] *See Interpreting Nonshareholder*, *supra* note 197, at 995–96. In practice, the conduct of Delaware directors is often even more shielded from judicial review thanks to the demand requirement in shareholder derivative suits. In Delaware,

> [a] stockholder may not pursue a derivative suit to assert a claim of the corporation unless the stockholder: (a) has first demanded that the directors pursue the corporate claim and the directors have wrongfully refused to do so; or (b) establishes that pre-suit demand is excused because the directors are deemed incapable of making an impartial decision regarding the pursuit of the litigation.

Wood v. Baum, 953 A.2d 136, 140 (Del. 2008) (citations omitted). And the only grounds for successfully arguing demand futility are the same as those for preventing application of the business judgment rule: improper director self-interest. *Id.*

[220] *See Business Judgment Rule*, *supra* note 38 at 102–09.

[221] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

[222] *Id.* at 872.

[223] *See Business Judgment Rule*, *supra* note 38, at 122.

[224] *See* Eisenberg, *supra* note 189, at 444.

> new truck today?" or "should we give Joe a raise?" are simplistically, types of business judgments which the rule was developed to protect. Courts have no place substituting their judgments for that of the directors.[225]

In other words, the business judgment rule is not a tangential or accidental component of Delaware corporate law.[226] Rather, it reflects a crucial and central policy about the allocation of decision-making authority in the modern corporation.[227] If courts do not give some level of deference to corporate directors but are instead required (or even permitted) to evaluate the substantive merits of their every decision, judges become the ultimate decision-makers of corporate law.[228] Giving the Delaware judiciary the ability to regularly override board decisions would effectively install it as a kind of "uber" board over nearly every public company in the United States.[229] The business judgment rule thus ensures that does not happen, and instead allows duly elected directors to retain the ultimate authority over the corporation's resources.[230] Eliminating or limiting the business judgment rule, then, would have drastic implications not just for the corporate social responsibility debate, but for the whole of corporate law.[231]

While a full defense of the business judgment rule is outside the scope of this Article, based on the discussion above it is sufficient to say that any decision to eliminate or restrict the rule's application should not be made lightly.[232] And when it comes to the debate on corporate social responsibility, the consequences are profound.[233] When the business judgment rule applies to a

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[225] Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252, 1259 (S.D.N.Y. 1985); s*ee also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1374 (Del. 1995) ("The business judgment rule has traditionally operated to shield directors from personal liability arising out of completed actions involving operational issues" so long as they are "acting without self-interest and in good faith.").

[226] *See Business Judgment Rule*, *supra* note 38, at 83–84.

[227] *See id.* at 87 ("[T]he business judgment rule is the principal mechanism by which corporate law resolves th[e] tension [between director authority and accountability].").

[228] *See id.* at 122.

[229] *See In Defense of the Shareholder*, *supra* note 10, at 1424.

[230] *See Business Judgment Rule*, *supra* note 38, at 87.

[231] *See In Defense of the Shareholder*, *supra* note 10, at 1424.

[232] *See supra* Section III.A.

[233] *See supra* notes 54–57 and accompanying text.

particular corporate decision, shareholders cannot hold directors to any substantive standard of conduct at all, whether it be exclusive benefit or otherwise.[234] This affords directors wide latitude to engage in stakeholder interested conduct of various kinds.[235] Thus, for shareholder plaintiffs who hope to prevent such conduct by enforcing the exclusive benefit principle, what matters are the circumstances under which the protections of the business judgment rule are removed.[236] There are two distinct scenarios in which a Delaware court will refuse to apply the business judgment rule and instead apply a heightened standard of review.[237]

The first scenario under which a heightened standard of review is triggered has been characterized as "structural" or "ownership claim" issues—that is, decisions involving contested changes over corporate ownership.[238] While the following Section addresses these types of claims more thoroughly, it is worth pausing here to draw attention to the other half of the equation: Anytime a corporate decision does not involve a change in corporate ownership—which, unsurprisingly, describes the vast majority of corporate decisions—the business judgment rule applies and Delaware courts will not substitute their judgment for the judgment of directors.[239] Leading corporate legal scholars like Stephen Bainbridge and Bayless Manning have respectively referred to these matters as a company's "operational"[240] or "enterprise"[241] issues. But just

[234] *See Business Judgment Rule, supra* note 38, at 97 (describing with approval application of the business judgment rule in *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. 1968), and noting "the court did not require [the director defendants] to show either that such considerations [of potential legitimate business reasons] motivated their decisions or that the decision otherwise redounded to the corporation's benefit.").

[235] *See* Eisenberg, *supra* note 189, at 444.

[236] *See* Celia R. Taylor, *The Inadequacy of Fiduciary Duty Doctrine: Why Corporate Managers Have Little to Fear and What Might Be Done About It*, 85 OR. L. REV. 993, 1017 (2006).

[237] *See infra* notes 238–56 and accompanying text.

[238] *See supra* Part I.

[239] *See id.*

[240] *Interpreting Nonshareholder*, *supra* note 197, at 976 ("[O]ne thing can be said with considerable confidence: shareholder challenges to operational decisions usually fail.").

[241] Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom after* Van Gorkom, 41 BUS. LAW. 1, 5 (1985).

because these issues do not involve changes in corporate ownership, does not mean they are not incredibly important for the corporation as a whole.[242] As Manning provides:

> An example of an enterprise issue would be a decision by the board to expand or contract the company's steel operations in the United States .... A shareholder has an economic stake in major enterprise issues, of course. If a slide rule manufacturer expands its traditional business just as electronic calculators sweep the market, the company will go broke; the result of the board's decision on that enterprise issue will be that shareholders (or some later generation of shareholders) will lose their investment.[243]

Despite the potential for enterprise or operational issues to have major economic impact, in other words, they will nonetheless be evaluated under the business judgment rule.[244]

The second scenario is alleged duty of loyalty violations.[245] To be sure, it is often said that the business judgment rule protects directors against alleged violations of the duty of care and not against alleged violations of the duty of loyalty.[246] According to this shorthand, corporate directors who violate their duty of loyalty to shareholders will be reviewed with the strictest standard of

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[242] *See id.*

[243] *See id.*

[244] *Id.* at 6 ("Our corporation laws grant to directors exclusive power, or primary power, or shared power to decide most enterprise issues and many ownership claim issues.").

[245] *See supra* Part I.

[246] *See, e.g.*, Easterbrook & Fischel, *supra* note 129, at 433 ("To equity investors, the duty of loyalty is strong but the duty of care is weak (the 'business judgment rule' blocks inquiry, and negligent management is not actionable)."); Ronald J. Gilson, *Unocal Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 495 (2001) (explaining that prior to Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), which is discussed in greater detail below, "[c]orporate law provided two general standards of review of management conduct: the business judgment rule, applicable to claims that management violated its duty of care; and the intrinsic fairness test, applicable to claims that management violated its duty of loyalty."); Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3293–94 (2013) [hereinafter *Geography of* Revlon-*Land*]; *see also* Bayer v. Beran, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944) ("The 'business judgment rule,' however, yields to the rule of undivided loyalty. This great rule of law is designed 'to avoid the possibility of fraud and to avoid the temptation of self-interest.'" (internal quotations omitted)).

review under Delaware law: the entire fairness standard.[247] But, as we have seen, the precise definition of the duty of loyalty makes all the difference.[248] And as explained below, the duty of loyalty violations that trigger the entire fairness standard are limited to violations of its narrower formulation, what this Article has called "disinterestedness".[249] Disinterested directors who allegedly violate only the exclusive benefit principle will thus remain protected by the highly deferential business judgment rule.[250] The result, as explained in the following Section, is that directors have an enormous amount of freedom to provide benefits to nonshareholder constituencies, and because these decisions are "nonreviewable,"[251] there is nothing shareholders can do about it.[252]

B. The Duty of Loyalty and Enhanced Scrutiny

Shareholders have more power to hold directors to the exclusive benefit principle when their decisions are reviewed under Delaware's intermediate standard of review: enhanced scrutiny.[253] Delaware courts developed this standard in response to the takeover boom of the 1980s, and it is seen as a middle ground between the highly deferential business judgment rule and the exacting standard of entire fairness (discussed in the following Section).[254]

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[247] *See, e.g.*, Eisenberg, *supra* note 189, at 438 ("The duty of loyalty concerns the standards of conduct and review applicable to a director or officer in taking action, or failing to act, in a matter that does involve his own self-interest.").

[248] *See id.*

[249] *See id.*; *see also* Section III.B.

[250] *See* Eisenberg, *supra* note 189, at 438.

[251] *See, e.g.*, Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 521 (1988) ("It is hard to find reported examples of these "nonreviewable" decisions precisely because it is so well understood that they cannot profitably be made the subject of lawsuits. A dividend may be illegal because it exceeds the amount permissible under the statute, but we have no concept of a "negligent" dividend policy even though hindsight indicates that a different allocation between retention and payout of earnings may have been wiser." Similarly, courts will not entertain stockholder complaints that the board should have directed management to devote more effort to research and development or to manufacture this, rather than that, product or that X would have made a better chief financial officer than Y.").

[252] *See id.* at 521.

[253] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 28 (Del. Ch. 2010).

[254] *See* Bebchuk & Tallarita, *supra* note 12, at 106.

The problem, however, is that Delaware courts apply enhanced scrutiny only to a very limited subset of corporate actions that involve contested claims to the corporation's ownership.[255] For everything else, the default is still the business judgment rule, including for most of the decisions that animate the corporate social responsibility debate: the compensation and treatment of employees, the welfare and safety of customers, the protection of the environment and the community, etc.[256] Corporate policies and decisions in all of these categories are never subjected to enhanced judicial scrutiny—but because the cases applying this standard are often discussed in debates about corporate social responsibility, this Article addresses them below.[257]

1. Defensive Measures

The first type of corporate action that receives enhanced scrutiny in Delaware courts is directors' responses to unsolicited or hostile takeover attempts by third parties, which are evaluated under the 1985 case of *Unocal v. Mesa Petroleum Co.*[258] In *Unocal*, Unocal directors adopted a selective share repurchase (a predecessor of the "poison pill" defense) that made it much more difficult for the prospective acquirer to complete his tender offer successfully.[259] The court reviewed the rationale of the business judgment rule and concluded that nothing about an unsolicited tender offer changes Delaware directors' standard of conduct or the "basic principle that directors have a fiduciary duty to act in the best interests of the corporation's stockholders."[260] Instead, it is the presence of the inherent conflict of interest—"that the directors may ... have acted solely or primarily out of a desire to perpetuate themselves in office"—that justifies a heightened standard of review.[261]

Enhanced scrutiny thus imposes a check on directors' discretion, at least when compared to the discretion they command

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[255] *Interpreting Nonshareholder*, *supra* note 197, at 981.
[256] *Id.*
[257] *See, e.g.*, *id.* at 981–84, *supra* Section III.B.1.
[258] 493 A.2d 946, 949 (Del. 1985).
[259] *Id.*
[260] *Id.* at 955.
[261] *Id.* (citing Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964)).

in the operational context.[262] When implementing defensive measures, this discretion is subject to two tests.[263] First, directors may not respond to "any perceived threat by any Draconian means available."[264] And second, it is required that any defensive measures be reasonable:

> [A] defensive measure [will] come within the ambit of the business judgment rule [if it is] *reasonable in relation* to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange.[265]

Notice, though, that this application of enhanced scrutiny by Delaware courts still does not mean that the standard of review is equivalent to the standard of conduct.[266] Rather than asking if directors acted for the Exclusive Benefit of shareholders (the standard of conduct), Delaware courts ask if directors' defensive measures were draconian or unreasonable (the standard of review).[267] In other words, *Unocal* is basically a reasonableness (or negligence) standard—the court expressly held that consideration of the effects of the takeover threat on nonshareholder constituencies was reasonable.[268]

Cases since *Unocal* have only confirmed this conclusion.[269] For example, in *Paramount Communications v. Time*, the Time

[262] *See Cheff*, 199 A.2d at 556.

[263] *See Unocal*, 493 A.2d at 556.

[264] *Id.*

[265] *See id.* at 955.

[266] *See In re* Trados Inc., 73 A.2d 17, 36 (Del. Ch. 2013).

[267] *Id.*; *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995) (describing *Unocal*'s enhanced scrutiny analysis as "first, upon whether the [defensive measure] implemented was *draconian, by being either preclusive or coercive* and; second, if it was not draconian, upon whether it was within a *range of reasonable responses* to the threat [the tender offer] posed." (first and second emphasis added)).

[268] *See supra* Part I.

[269] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1142 (Del. 1989).

directors rejected a tender offer made by Paramount shortly after Time had entered into agreements to merge with Warner.[270] The court held that the Time directors' actions were reasonable because after an informed investigation they concluded in good faith that Warner was the "best 'fit' for Time to achieve its strategic objectives" and allowed for "the preservation of Time's 'culture,' i.e., its perceived editorial integrity in journalism."[271] Further, the court held that the Time board satisfied *Unocal*'s other prong because Time's response was not "coercive in nature" in the sense that it "was not aimed at 'cramming down' on its shareholders a management-sponsored alternative, but rather had as its goal the carrying forward of a pre-existing transaction in an altered form."[272]

To be clear, the argument is not that decisions like *Unocal* and *Paramount* give directors free reign to serve other constituencies to the detriment of shareholder value—dicta in those decisions (and in subsequent ones) expressly reject this position.[273] The fact that Delaware courts apply enhanced scrutiny in the hostile takeover context does not change anything about shareholders' ability to enforce the exclusive benefit principle for every other corporate decision outside of that context, no matter how important it may be for shareholders or stakeholders alike.[274]

This is also true about the more recent decision of *eBay Domestic Holdings, Inc. v. Newmark*,[275] a decision in the *Unocal* line of cases that commentators often cite as evidence of the willingness of Delaware courts to enforce the interests of shareholders over those of all other groups.[276] A closer look at the decision

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[270] *Id.*

[271] *Id.* at 1152.

[272] *Id.* at 1154–55. Further, the *Paramount* court held that Time's response was "proportionate" to the threat posed by Paramount's offer because "the revised agreement and its accompanying safety devices did not preclude Paramount from making an offer for the combined Time-Warner company or from changing the conditions of its offer so as not to make the offer dependent upon the nullification of the Time-Warner agreement." *Id.* at 1155.

[273] *Id.* at 1140; *see also* Unocal v. Mesa Petroleum, 493 A.2d 946, 946 (Del. 1985).

[274] *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1363 (Del. 1995).

[275] 16 A.3d 1 (Del. Ch. 2010).

[276] *See, e.g.*, David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 224 [hereinafter *The Law of Corporate Purpose*] (referring to

reveals how little relevance it has, as a practical matter, for the corporate social responsibility debate.[277]

In *eBay*, one of the three founders of the classified ads site craigslist, Inc. had sold his interest in craigslist to eBay under certain conditions agreed to by the other two craigslist founders.[278] But after eBay began another venture that competed with craigslist, the two remaining founders, Jim and Craig, made changes to craigslist's governance structure that sought to block eBay's ongoing influence on craigslist, including "the indefinite implementation of a poison pill," or "Rights Plan."[279] In defending this move at trial, Jim and Craig "advisedly described craigslist's business using the language of 'culture' because that was what carried the day in *Time*."[280] But the Court of Chancery did not buy it, finding that "there is nothing about craigslist's corporate culture that *Time* or *Unocal* protects. The existence of a distinctive craigslist 'culture' was not proven at trial. It is a fiction, invoked almost talismanically for purposes of this trial in order to find deference under *Time's* dicta."[281]

On its face, *eBay* demonstrates the limits of Delaware's authorization in *Time* for directors to consider nonshareholder interests in the implementation of defensive measures.[282] But a closer look reveals just how extraordinary the *eBay* case was. The court explained that no evidence had been introduced to show that Jim and Craig had even *considered* whether the protection of craigslist "culture" via the Rights Plan would redound in some way to increased shareholder value.[283] Instead,

> Jim and Craig simply disliked the possibility that the Grim Reaper someday will catch up with them and that a company like eBay might, in the future, purchase a controlling interest in craigslist. They considered this possible future state unpalatable, not because of how it affects the value of the entity for its stockholders, but rather *because of their own personal preferences*.

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eBay as a case "where Delaware does enforce the shareholder primacy obligation.").

[277] *See id.*

[278] *See eBay*, 16 A.3d at 6.

[279] *Id.* at 32–33.

[280] *Id.* at 33.

[281] *Id.*

[282] *Id.* at 30.

[283] *Id.* at 34

> Jim and Craig therefore failed to prove at trial that they acted in the good faith pursuit of a proper *corporate* purpose when they deployed the Rights Plan. Based on all of the evidence, I find instead that Jim and Craig resented eBay's decision to compete with craigslist and adopted the Rights Plan as a punitive response. They then cloaked this decision in the language of culture and *post mortem* corporate benefit. Although Jim and Craig (and the psychological culture they embrace) were the only known beneficiaries of the Rights Plan, such a motive is no substitute for their fiduciary duty to craigslist stockholders.[284]

In other words, the facts upon which the court based its decision were particularly unusual and unfavorable for the director defendants.[285] At bottom, *eBay* is not a case about directors choosing in good faith to benefit other stakeholders at the expense of shareholders.[286] It is a case about directors attempting to restrict the power of a particular shareholder over the corporate enterprise, and subsequently trying to cover up that attempt with the pretext of stakeholder benefit.[287]

The lesson here is an important one. A case like *eBay* shows that Delaware courts have occasionally, in the hostile takeover context and on extraordinary facts, allowed shareholders to overturn directors' decisions that were justified by their benefits to stakeholders.[288] But when read in conjunction with *Unocal* and *Time*, *eBay* demonstrates how rare such decisions actually are.[289] As the Article explains, the extent to which *eBay* would apply to directors' decisions that were made in good faith is highly doubtful, and for decisions that do not involve defensive measures, it would not apply at all.[290]

2. Changes of Control

The other type of corporate action that Delaware courts review with enhanced scrutiny is the directors' decision to sell a

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[284] *See id.*

[285] *See id.*

[286] *See id.* at 32.

[287] *See id.*

[288] *See id* at 46.

[289] *Compare id.*, *and* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958–59 (Del. 1985), *with* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154–55 (Del. 1990).

[290] *See eBay*, 16 A.3d at 35.

controlling stake of the corporation.[291] Less than a year after *Unocal*, the Supreme Court of Delaware issued its seminal *Revlon* opinion, which confined *Unocal* in important respects.[292] *Revlon* began much like *Unocal*, with the Revlon board attempting to thwart an unwelcomed tender offer that had been made by a company called Pantry Pride.[293] Pantry Pride made several offers to acquire a majority of Revlon's shares, each of which the Revlon board determined were inadequate.[294] In response, Revlon began negotiations with an investment firm called Forstmann Little & Co. in hopes of a friendly acquisition and a bidding war ensued.[295] Eventually, the Revlon board rejected Pantry Pride's offer and agreed to an offer by Forstmann.[296] Pantry Pride sought to enjoin this transaction in the Delaware Court of Chancery, and raised its offer so that it again beat Forstmann's.[297]

Importantly for this discussion, the Revlon board justified its selection of Forstmann's offer over Pantry Pride's offer on the grounds that it afforded better treatment to the holders of outstanding Revlon notes, who were threatening litigation after the notes had dropped in market value during the bidding war.[298] And even though bondholders are not typically featured prominently in the corporate social responsibility debate, they are similar to employees and customers in that their rights are fixed by contract and they are not owed fiduciary duties by directors.[299]

The Delaware Supreme Court began its analysis under the *Unocal* framework, but then explained how the difference in circumstances required a difference in the directors' duties:

> The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had

[291] *See Unocal Corp.*, 493 A.2d at 954.

[292] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 176 (Del. 1986).

[293] *Compare Revlon,* 506 A.2d at 175, *with Unocal*, 493 A.2d at 949–53.

[294] *See Revlon*, 506 A.2d at 176–77.

[295] *See id.* at 178.

[296] *See id.*

[297] *See id.* at 179.

[298] *See id.* at 183–84.

[299] *See id.* at 182.

> thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[300]

In short, once the board has decided to sell control of the company, directors' fulfillment of their fiduciary duties becomes unusually simple: obtain the highest price for the shareholders.[301]

The *Revlon* court also clarified that while *Unocal* expressly permitted directors to consider nonshareholder constituencies like the noteholders, "there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, *provided there are rationally related benefits accruing to the stockholders*."[302] Further, the court explained that "such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder."[303] Accordingly, the Delaware Supreme Court held that:

> the Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract. The noteholders required no further protection, and when the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders, the directors breached their primary duty of loyalty.[304]

Thus, *Revlon* sets forth another set of circumstances under which shareholders are able to enforce the exclusive benefit

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[300] *Id.*
[301] *See id.*
[302] *Id.* (citing *Unocal*, 493 A.2d at 955) (emphasis added).
[303] *Revlon*, 506 A.2d at 182.
[304] *Id.* (citations omitted).

principle against Delaware directors.[305] As scholars and courts have noted, *Revlon* does not change directors' standard of conduct but instead provides a specific application of it in the sale-of-control context: Because directors must act for the exclusive benefit of shareholders, it follows naturally that when the company is for sale, directors are obligated to seek the best deal for the shareholders, without regard for other constituencies.[306] But when Delaware courts review such decisions, they do not ask simply whether directors obtained the best price for shareholders, but instead ask whether the board took reasonable steps to get the best price reasonably available.[307]

3. The Limits of Enhanced Scrutiny

Enhanced scrutiny thus applies in two different but related scenarios involving contested claims of ownership.[308] As long as a corporation has long-term prospects, as in *Unocal* (and *eBay*), Delaware courts prohibit directors from implementing defensive measures that are coercive or preclusive (i.e., "draconian"), while nonetheless granting them a meaningful amount of discretion to consider a tender offer's potential impact on various constituencies, so long as the measures they implement are within the range of reasonableness.[309] But, once the directors have decided that control of the company is up for sale, under *Revlon*, directors' fiduciary duties are simplified into an obligation to obtain the best price reasonably available for the shareholders, lest any

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[305] *Id.* at 184.

[306] *Id.* at 181.

[307] Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1994) ("Although an enhanced scrutiny test involves a review of the reasonableness of the substantive merits of a board's actions, a court should not ignore the complexity of the directors' task in a sale of control. There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decision-making body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision.").

[308] *See Interpreting Nonshareholder*, *supra* note 197, at 980–84.

[309] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367, 1389 (Del. 1995).

favoritism towards nonshareholders be used as pretext for improper self-interest.[310]

Undoubtedly, cases like *eBay* and *Revlon* stand as promising examples for shareholders looking to enforce the exclusive benefit principle and root out stakeholder interested conduct, at least when compared to cases that are decided under the business judgment rule.[311] But it would be unwise to overstate their importance to the corporate social responsibility debate.

First of all, it is directors who retain the ultimate decision-making authority as to whether a controlling stake in the company is for sale, as subsequent decisions have declined "to extend *Revlon*'s application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up for sale.'"[312] This has led to the emergence of new terms of art, such as "*Revlon*-land,"[313] the (metaphorical) place in which corporate directors find themselves after "*Revlon* duties" are "triggered"—but the short of it is that directors have considerable discretion over whether they will ever be governed by *Revlon* at all.[314]

In sum, shareholders looking to enforce a strict principle of exclusive benefit against directors would likely have better luck under enhanced scrutiny than under the business judgment rule,[315] given that courts applying *Unocal* or *Revlon* will ask whether directors took reasonable steps in the interests of shareholders,[316] both of which leave little room for directors to get away with serving the interests of nonshareholder constituencies.[317] But, as a practical matter, these cases are so limited in their application that they do virtually nothing to empower shareholders to root

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[310] *Revlon,* 506 A.2d at 182.

[311] *Compare* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 46 (Del. Ch. 2010), *with Revlon,* 506 A.2d 173, 184.

[312] *Paramount*, 571 A.2d at 1151 (holding that *Revlon* duties were not triggered by the board of directors' decision to enter a merger agreement).

[313] *See, e.g.*, *Geography of* Revlon-*Land*, *supra* note 246, at 3280 n.7 (2013).

[314] *See Interpreting Nonshareholder*, *supra* note 197, at 987.

[315] *In re* Rural Metro Corp., 88 A.3d 54, 82 (Del. Ch. 2014) (citing *Revlon*, 506 A.2d at 180–82).

[316] *Compare* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985), *with Revlon*, 506 A.2d at 179, 182.

[317] *See Interpreting Nonshareholder*, *supra* note 197, at 982–83.

out the vast majority of stakeholder interested conduct, which receives the protection of the business judgment rule.[318]

C. The Duty of Loyalty and Entire Fairness

Unlike enhanced scrutiny, the entire fairness standard of review is triggered not by a corporate action being of a specific type, but by a corporate director having a material conflict of interest.[319] As such, an entire fairness analysis can be triggered in transactions that would generally be reviewed under the business judgment rule as well as in transactions that would already be subject to enhanced scrutiny.[320] In either case, however, the triggering condition is the same: the inherently self-interested nature of the transaction involved.[321]

Recall that the business judgment rule is Delaware's default standard of review.[322] What must a shareholder plaintiff show to rebut the presumption of the business judgment rule under an allegation of director disloyalty? Delaware law offers only one conceptual path: establishing that the director is not "disinterested and independent."[323] This means, for example,

> that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.[324]

This is a paradigmatic expression of what this Article calls the principle of disinterestedness, and in Delaware corporate jurisprudence this principle is enforced with full strength.[325] If a shareholder plaintiff establishes that a director had a "material

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[318] *See id.* at 1015.

[319] *See In re* Trados Inc., 73 A.2d 17, 44 (Del. Ch. 2013).

[320] *See id.* at 43–44.

[321] *See id.* at 36.

[322] *See id.* at 43.

[323] Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

[324] *Id.* at 812 (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)); Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430 (Del. Ch. 1968)).

[325] *See Aronson*, 473 A.2d at 806.

self-interest"[326] in the transaction, the protections of the business judgment rule are lifted, and a Delaware court will review the transaction under the exacting "entire fairness" standard.[327]

On the other hand, Delaware law does not consider directors' stakeholder interested conduct to be a qualifying violation of the duty of loyalty that would overcome the presumptions of the business judgment rule and require entire fairness review.[328] The Delaware courts' laser focus on director self-interest, while completely justified in context, means that director conduct that is not self-interested is subjected to almost no judicial scrutiny at all.[329] A shareholder plaintiff who shows merely that a director intended to benefit nonshareholder constituencies like employees or customers—without showing the director sought to benefit herself—cannot avoid the application of the business judgment rule, which entirely insulates the director's decision from judicial review.[330] Shareholders are thus entirely unable to enforce the broad principle of Exclusive Benefit against directors in the operational context.[331]

Entire fairness can also be triggered in cases involving ownership claim issues.[332] However, much like the operational context, only violations of the narrow definition of the duty of loyalty, disinterestedness, trigger this heightened standard: "Where actual self-interest is present and affects a majority of the directors approving a transaction, a court will apply even more exacting scrutiny to determine whether the transaction is entirely fair to the stockholders."[333] As discussed above, mere stakeholder

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[326] Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1168 (Del. 1995).

[327] Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.") (citing Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 110 (Del. 1952)); Bastian v. Bourns, Inc., 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970); David J. Greene & Co., 249 A.2d at 431.

[328] *See In re* Opus East, LLC, 528 B.R. 30, 66 (Bankr. D. Del. 2015).

[329] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010).

[330] *See id.*

[331] *See id.* at 36.

[332] *See Weinberger*, 457 A.2d at 711.

[333] Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 42 n.9 (Del. 1994) (citing *Weinberger*, 457 A.2d at 710–11; Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993)).

interested conduct in ownership claim cases is reviewed under enhanced scrutiny.[334]

Because of this, when it comes to the debate on corporate social responsibility, the entire fairness standard of review has little relevance.[335] Director conduct that is merely stakeholder interested will never be subjected to entire fairness review given that, by definition, it includes only conduct that is not tainted by director self-interest.[336] The result is that when directors make disinterested decisions on how to distribute resources within the firm, shareholders have no power to require them to prove to a judge that their decisions were entirely fair.[337]

IV. THE USE AND MISUSE OF FIDUCIARY DUTIES

For decades, scholars of all stripes have made normative arguments that corporate directors should owe fiduciary duties not just to shareholders, but also to other constituencies.[338] Some focus exclusively on employees and customers, others exclusively on creditors, and still others make more generalized proposals to apportion the benefits of fiduciary duties to each corporate constituency (including shareholders) according to its contributions to the firm.[339] In each case, the point of these proposals is to protect corporate constituencies considered vulnerable to director misconduct by creating a legal requirement that directors serve their best interests as well, instead of serving only the interests of shareholders.[340]

While it often goes without saying, each of these proposals is based on this fundamental premise: Being owed corporate fiduciary duties meaningfully protects you against corporate conduct that favors other constituencies at your expense.[341] As explained above, however, under current Delaware corporate law, directors'

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[334] *See Interpreting Nonshareholder*, *supra* note 197, at 980–82, 984; *supra* Section III.B.

[335] *See supra* Section III.B.

[336] *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1168 (Del. 1995).

[337] *See id.*

[338] *See supra* Section I.B.

[339] *See id.*

[340] *See id.*

[341] *See* Blair & Stout, *A Team Production Theory of Corporate Law*, *supra* note 27, at 287.

duty of loyalty requiring them to seek the exclusive benefit of shareholders—the standard of conduct—is weakened significantly in practice by the deferential standard of review by which Delaware courts evaluate such conduct, the business judgment rule.[342] The result is that in almost every case, shareholders are virtually powerless to prevent directors from engaging in conduct that benefits nonshareholder constituencies, or what this Article has called stakeholder-interested conduct.[343] And inversely, as explained next, if Delaware law were amended so that corporate directors owed fiduciary duties to nonshareholder groups, such groups would likewise be virtually powerless to prevent director conduct that they find similarly unfavorable—at least not without a corresponding change to the triggering conditions of Delaware's standards of review.[344]

A. Fiduciary Protection for Shareholders

Given the wide gap between the standard of conduct and the standard of review, perhaps it is no surprise that scholars disagree sharply on what corporate directors ought to do.[345] Some have argued at length that the freedom provided by the business judgment rule amounts to a legal authorization for directors to engage in stakeholder interested conduct whenever enhanced scrutiny or entire fairness do not apply.[346] Others emphatically reject that position, arguing that while Delaware law does not strictly

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[342] *See supra* Section III.B.

[343] *See infra* Section IV.A.

[344] *See id.*

[345] *Compare* Blair & Stout, *A Team Production Theory of Corporate Law*, *supra* note 27, at 1747, 1756–57, 1780, *and* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 868–69 (2005), *with* Steven Bainbridge, *The Relationship Between the Shareholder Wealth Maximization Norm and the Business Judgment Rule*, professorbainbridge.com (May 5, 2012) [hereinafter *The Relationship Between*], http://www.professorbainbridge.com/professorbainbridgecom/2012/05/the-relationship-between-the-shareholder-wealth-maximization-norm-and-the-business-judgment-rule.html [https://perma.cc/A7R3-8BPH].

[346] The two most sophisticated defenses of this position are Blair & Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, *supra* note 127, at 1736, and Elhauge, *supra* note 345, at 753.

enforce the exclusive benefit norm in every case, this is merely "an unintended consequence of the business judgment rule."[347]

To scholars in this latter camp, the business judgment rule doesn't change the fact that Delaware "directors may [not] subordinate what they believe is best for stockholder welfare to other interests, such as those of the company's workers or society generally."[348] The point, as they see it, "is not whether the law permits directors to engage in *pretext*, it is what the law allows them to do expressly and forthrightly."[349] As such, these scholars have focused on the symbolic power of decisions like *Revlon* and *eBay*, which they admit apply only in discrete contexts,[350] instead of on the space created by this deferential standard of review:

> The issue ... is not what directors *might get away with* in the courtroom but what the law calls on directors to think and do in the boardroom. *Revlon* and *eBay* tell us that directors' decisions must truly, actually, sincerely, be made in the best interests of the shareholders.[351]

If directors can't openly favor nonshareholder groups at the expense of shareholders, the argument goes, then it cannot be said that they have the power to do so.[352]

But it is helpful to look at this from the other direction—not what directors can do but what shareholders have the power to prevent them from doing. Do fiduciary duties give shareholders the power to intervene every time corporate directors engage in stakeholder interested conduct? Must they act secretly or dishonestly to be sure they can "get away" with it? Must they engage in "pretext" each time they do so? Not at all.[353] What the business judgment rule provides directors is not simply an opportunity to insert pretext or other trickery into their decisions, but rather the freedom from having to justify their decisions to a Delaware court at all.[354]

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[347] *See The Relationship Between*, *supra* note 345.

[348] *Dangers of Denial*, *supra* note 48, at 764.

[349] *Id.* at 782–83 n.84 (emphasis added); s*ee also The Law of Corporate Purpose*, *supra* note 276, at 1236.

[350] *See Dangers of Denial*, *supra* note 48, at 782–83 n.84.

[351] *The Law of Corporate Purpose*, *supra* note 276, at 225 (emphasis added).

[352] *See id*.

[353] *See infra* notes 355–59 and accompanying text.

[354] *See infra* notes 355–59 and accompanying text.

For example, when Google Inc., a Delaware corporation, went public, its directors could and did acknowledge their "duty as fiduciaries for [their] shareholders" while nonetheless committing to fulfill their "responsibilities to [their] shareholders, employees, customers and business partners."[355] While these latter responsibilities are not of a fiduciary nature, of course, they allow Google to provide "many unusual benefits to [its] employees" and openly declare its intentions "to add benefits over time rather than pare them down."[356] It is not that these examples are violations of the duty of loyalty, but precisely the opposite: Google shareholders were powerless to stop them.[357] No doubt the Google directors received plenty of legal advice on what to say and what not to.[358] But, in the end, did they need to be secretive about these actions, or to play them down in any way? Did they open themselves up to liability from shareholder suits trying to take them to task for ignoring their interests? Did they ever get called in front of a judge to present evidence that these benefits would ultimately redound to shareholders? None of the above.[359]

Of course, corporate directors regularly do attempt to draw the connection between benefits they provide to nonshareholders and increased shareholder value.[360] Sometimes they explain the connection in detail, and other times they simply state in the most general terms, as the Google directors did at their IPO, that they were "careful to consider the long-term advantages to the company of these benefits."[361] But do they ever have to convince anyone that these long-term advantages are worth it for shareholders? No, and here is why.[362]

Recall that, when directors are not self-interested or grossly negligent, a court reviewing their decision will ask only whether their decision was made with a good faith belief that it would

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[355] *See* Larry Page & Sergey Brin, *2004 Founders' IPO Letter: "An Owner's Manual" for Google's Shareholders*, GOOGLE, https://abc.xyz/investor/founders-letters/2004/ipo-letter.html [https://perma.cc/W4P8-THML].

[356] *Id.*

[357] *See Business Judgment Rule*, *supra* note 38, at 87.

[358] *See* Page & Brin, *supra* note 355.

[359] *See The Relationship Between*, *supra* note 345.

[360] *See* Page & Brin, *supra* note 355 (explaining how benefits to nonshareholders will benefit shareholders).

[361] *Id.*

[362] *See infra* notes 363–74 and accompanying text.

advance the best interest of the corporation and its shareholders.[363] Then, for example, consider specifically the "unusual" employee benefits Google offers.[364] The tech company is known for such above-market employee perks like free gourmet meals and snacks, free rides to work, professional massages at the office, and generous parental leave and life insurance benefits.[365] Given that these benefits are above and beyond what any employees could claim is contractually owed to them, Google shareholders might consider them an improper use of the corporation's resources—after all, directors' fiduciary duties require them to use those resources for the benefit of shareholders alone.[366] But even though Google directors did not defend themselves (and did not have to), a defense of their actions is readily forthcoming: Such employee benefits allow Google to attract and retain the highest quality employees, to improve morale, and to increase productivity—benefits that ultimately redound to shareholders in the form of increased profits.[367]

Similar arguments can be made about any benefit offered to other nonshareholder constituencies.[368] Benefits to customers, like discounts and warranties, can be expected to increase sales (and thus profits), an obvious benefit to shareholders.[369] Playing nice with creditors will likely decrease the cost and increase the availability of the corporation's debt capital, adding further to the corporation's bottom line.[370] Even benefits provided to less concrete constituencies—like the environment or various charitable or social causes—contribute to a corporation's brand in ways that can be expected to improve that corporation's standing in the marketplace, which again comes right back to the shareholders.[371]

In short, for virtually any conceivable action that corporate directors take for the benefit of a nonshareholder constituency,

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[363] *See supra* Section III.A.

[364] *See* Page & Brin, *supra* note 355.

[365] Jillian D'Onfro & Lucy England, *An Inside Look at Google's Best Employee Perks*, INC. (Sep. 21, 2015), https://www.inc.com/business-insider/best-google-benefits.html [https://perma.cc/ZRX2-V5M5].

[366] *See In Defense of the Shareholder*, *supra* note 10, at 1424.

[367] *See* Page & Brin, *supra* note 355.

[368] *See infra* note 385 and accompanying text.

[369] *See infra* note 385 and accompanying text.

[370] *See infra* note 385 and accompanying text.

[371] *See infra* note 385 and accompanying text.

there is an abundance of explanations for how such action ultimately redounds to the benefit of shareholders and thereby fulfills directors' fiduciary duties.[372] Given that this Article's thesis is descriptive in nature, it does not attempt to defend this normative argument here. For now, it is sufficient simply to demonstrate that under current Delaware law, this deference virtually eliminates shareholders' ability to prevent directors' apparent stakeholder interested conduct by suing for breaches of fiduciary duty.[373] Or, looking at it from the perspective of directors, their fiduciary duties to shareholders do virtually nothing to restrict their freedom to act according to social or moral concerns even when these concerns are apparently entirely unrelated to their businesses.[374]

A few more examples will help illustrate this point. A Delaware corporation like Delta Airlines can rescind travel discounts to members of the National Rifle Association in the wake of a school shooting.[375] Another Delaware corporation, Citigroup, can respond to the same by setting restrictions on the sale of firearms by business partners.[376] Yet another Delaware corporation, Walmart, can close its stores for a day "to conduct anti-bias training" for all of its employees.[377] In each example, shareholders could

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[372] *See infra* note 385 and accompanying text.

[373] *See infra* note 374 and accompanying text.

[374] *See, e.g.*, Samuel Hammond, *Elizabeth Warren's Corporate Catastrophe*, NAT. REV., Aug. 20, 2018, http://www.nationalreview.com/2018/08/elizabeth warren-accountable-capitalism-act-terrible-idea/ [https://perma.cc/Y9N7-863V] (stating that: "[i]n practice, corporate boards don't have a fiduciary duty to do much of anything in particular, outside of the standard prescriptions of common law. As an acquaintance who's spent decades working in large, publicly traded companies put it to me, "I often don't know what *does* motivate corporate decisions, but I can assure you it's not that.").

[375] Ed Bastian, *Delta and the School Safety Debate*, DELTA (March 2, 2018), https://news.delta.com/ed-bastian-memo-delta-and-school-safety-debate [https://perma.cc/74SQ-5PK4] ("Our decision was not made for economic gain and our values are not for sale.").

[376] Tiffany Hsu, *Citigroup Sets Restrictions on Gun Sales by Business Partners*, N.Y. TIMES (March 22, 2018), https://www.nytimes.com/2018/03/22/business/citigroup-gun-control-policy.html [https://perma.cc/MWZ8-FSMH].

[377] Rachel Abrams, *Starbucks Closes 8,000 U.S. Stores for Racial Bias Training After Arrests*, N.Y. TIMES (April 17, 2018), https://www.nytimes.com/2018/04/17/business/starbucks-arrests-racial-bias.html [https://perma.cc/JB2M-VYC7]; *see also* Kevin Johnson, *Starbucks CEO: Reprehensible Outcome in Philadelphia Incident*, STARBUCKS (April 14, 2018), https://news.starbucks.com/views/star

object on the grounds that the action harms shareholders by devoting corporate resources to another group, such as the victims of gun violence or improper bias, thereby reducing their profits.[378] And the directors might respond to such objections by explaining how the actions benefit shareholders, given that they can be expected to increase sales or goodwill or avoid future liability.[379] It is simply too easy for directors to—honestly and sincerely—believe that their actions, even when apparently done for the benefit of other constituencies, will benefit the interests of shareholders in the long run.[380]

The point is not that one of these arguments is right and the other is wrong but, to put it bluntly, that Delaware courts do not care.[381] So long as they are plausible, and they almost always are, the business judgment rule applies.[382] And the protections of the rule are so powerful that the Delta CEO, for example, could forego pretext entirely and instead proclaim that "[o]ur decision was not made for economic gain and our values are not for sale"[383]—of course, it is entirely possible that this statement was itself made for economic gain, but the point is he will never have to prove it.[384] Instead, Delaware courts treat "the interests of the shareholders as a class ... as congruent with those of the corporation in the long run," which means they presume that shareholders' interests are served by any corporate decision that could rationally be expected to benefit the enterprise as a whole.[385] This presumption expressly authorizes directors to act in ways that negatively affect the short-term interests of any given constituency (shareholder or otherwise) in pursuit of other long-term objectives.[386] In this way, nonshareholder constituencies

bucks-ceo-reprehensible-outcome-in-philadelphia-incident [https://perma.cc/U427-Q4HL].

[378] *See In Defense of the Shareholder*, *supra* note 10, at 1424.

[379] *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[380] *See id.*

[381] *See* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

[382] *See id.*

[383] *See* Bastian, *supra* note 375.

[384] *See Brehm*, 746 A.2d at 252.

[385] TW Servs., Inc. v. SWT Acquisition Corp., No. 10298, 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989).

[386] *Id.* (noting that: "directors, in managing the business and affairs of the corporation, may find it prudent (and are authorized) to make decisions that

regularly benefit from director decisions without any insincerity or dishonesty involved, and shareholders have no power to haul directors into Delaware courts to stop them.[387]

To be clear, this is not to suggest that under current Delaware law, nonshareholders have nothing to complain about because they are already getting plenty of benefits from directors. What pro-stakeholder theorists want is not simply for nonshareholder groups to receive incidental benefits when they happen to coincide with shareholder value, but instead the legal right to demand such benefits even when they do not.[388] That is why this Article's argument begins with the premise of nonshareholders' dissatisfaction, and proceeds to evaluate the potential that an extension of fiduciary duties might have to address and correct that dissatisfaction.[389] But, the next Section explains, fiduciary duties will not provide the solution they are looking for.[390]

In sum, even though shareholders are owed fiduciary duties by corporate directors, these duties do not empower shareholders to protect themselves from corporate decisions they believe unfairly favor nonshareholder constituencies.[391] Because the heightened standards of review in Delaware are triggered only by violations of disinterestedness and infrequent ownership control issues,[392] directors who engage in stakeholder interested

are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected, and thus directors in pursuit of long run corporate (and shareholder) value may be sensitive to the claims of other "corporate constituencies" (citations omitted)). *See also id.* at n.6 (noting that "[t]he list of such endeavors might touch upon every aspect of running the business: research and product development; personnel training and compensation; charitable and community financial support" (citations omitted)).

[387] *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) ("When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value. Under the *Unocal* standard, however, the directors must act within the range of reasonableness.").

[388] *See* Kent Greenfield, *Defending Stakeholder Governance*, 58 CASE W. RES. L. REV. 1043, 1044 (2008) (explaining stakeholder governance).

[389] *See supra* text accompanying note 7.

[390] *See infra* Section IV.B.

[391] *See supra* text accompanying note 157.

[392] *See* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (2011).

conduct are almost always protected by the business judgment rule—even though such conduct technically violates the duty of loyalty.[393] The result is that directors have nearly complete freedom to provide benefits to nonshareholder constituencies like employees, customers, creditors, the environment, etc.—and they are free to do so openly, honestly, and sincerely.[394]

If fiduciary duties do so little to empower shareholders to guard their interests over the interests of all other constituencies, though, is there any reason to believe that nonshareholder constituencies could adequately protect themselves from similarly unfavorable conduct simply by being owed fiduciary duties?

B. Fiduciary Protection for Nonshareholders

In recent decades, several scholars have argued that directors should owe fiduciary duties to nonshareholder constituencies, with the goal of empowering them to protect themselves from corporate actions that favor other corporate constituencies at their expense.[395] Proposals have sought fiduciary protection for groups as diverse as employees, customers, communities, creditors, and the environment; and, in most cases, the basic idea is that under current law directors are too beholden to shareholders, and that this ought to change.[396] For the sake of simplicity, this discussion focuses on the argument to extend corporate fiduciary duties to employees, which recent proposals have argued would protect them from unfavorable corporate conduct like "opportunistic firings"[397] or "exploitation."[398] However, the argument advanced in this Section applies to other nonshareholder constituencies as well.

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[393] *See id.*; *supra* Section II.B.

[394] *See supra* text accompanying notes 207–08.

[395] *See supra* text accompanying note 7; *supra* Section I.B.

[396] *See supra* text accompanying notes 20–33.

[397] *See* Bodie, *supra* note 2, at 867.

[398] O'Connor, *supra* note 124, at 965; *see also The Public Choice Problem*, *supra* note 17, at 1237 ("Under a stakeholderist corporate governance regime, directors are restrained by the golden yoke of fiduciary obligation from engaging in the kind of *exploitation* of nonshareholders that is impelled by the current system" (emphasis added)).

Some proposals for extensions of corporate fiduciary duties to employees have argued for substantive protections (i.e., employees are protected against certain corporate actions or results), while others have been limited to procedural protections (i.e., employees are owed special consideration, without any particular prescribed outcome).[399] Despite the differences between them, both types of proposals imagine a scenario in which employees are entitled to sue directors (or the corporation) to protect themselves from corporate decisions that do not go their way.[400] As explained above, however, even under current Delaware law—where directors owe fiduciary duties exclusively to shareholders—shareholders have almost no power to block corporate decisions they find unfavorable, due to Delaware's deferential standards of review.[401] As such, this Part argues that changing the law by extending directors' fiduciary duties to employees, without also changing the standard of review, will not empower employees to protect themselves against corporate decisions they believe unfairly benefit other constituencies at their expense.[402]

Of course, it is completely possible to argue that the standard of review for claims of directors' fiduciary violations should be changed as well.[403] But it is worth noting that proposals for fiduciary duties to employees do not actually make this argument, and instead largely presume that there would be a congruence between the standard of conduct governing directors and the standard of review by which courts would evaluate them.[404] Further, while it is outside the scope of this Article's descriptive argument, changing Delaware's standard of review to align perfectly the standard of conduct with the standard of review would not be a minor or inconsequential change.[405] Instead, it would disturb the fundamental principle in corporate law of directors' authority to manage the business and affairs of the corporation by allowing courts to intervene on nearly every corporate decision regardless of its impact

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[399] *See* Lehr, *supra* note 31, at 131.
[400] *See id.* at 117.
[401] *See* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (2011).
[402] *See supra* notes 416–17 and accompanying text.
[403] *See Reis*, 28 A.3d at 457.
[404] *See* Lehr, *supra* note 31, at 133.
[405] *See supra* Section III.A.

or magnitude.[406] And this conclusion—that there are convincing reasons to hold constant Delaware's standards of review—reinforces the argument of this Article that extending directors' fiduciary duties to nonshareholders would not provide them with meaningful protection.[407]

On the assumption, then, that all other rules of corporate law would remain unchanged, let's evaluate the idea of corporate directors owing fiduciary duties to employees. Begin with a paradigmatic example: a Delaware corporation debating whether to outsource a significant portion of its production overseas, which would result in the closure of its domestic production facility and the layoff of thousands of American workers. This is exactly the kind of corporate action that pro-stakeholder scholars care about: instances where corporate directors move corporate resources away from employees (in the form of lost wages and benefits) and their local community (in the form of decreased investment and development) to shareholders (in the form of increased profits).[408] And it is because constituencies like employees are especially vulnerable to such actions, the argument goes, that they should be owed fiduciary duties by directors so that they can protect themselves.[409]

Accordingly, some scholars have proposed fiduciary duties to employees that include rather robust substantive protections, such as the ability to sue directors (or the corporation) to prevent corporate decisions that are "opportunistic" or "exploitative."[410] As the argument goes, employees have made firm-specific investments in the corporation—having spent time developing knowledge of its products, processes, and people—that are not directly transferrable to other companies and thus will not produce the bargained-for payoff unless they are able to continue their work for this same corporation.[411] Laying them off before those firm-specific

[406] *See supra* Section III.A; *see also Business Judgment Rule*, *supra* note 38, at 85 (arguing in defense of the business judgment rule that "that corporate decision-making efficiency can be ensured only by preventing the board's decisionmaking authority from being trumped by courts under the guise of judicial review.")

[407] *See supra* notes 56–57 and accompanying text.

[408] *See* Bodie, *supra* note 2, at 867.

[409] *See id.*

[410] *See supra* notes 430–31 and accompanying text.

[411] *See* Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2017 (2013) (indicating the negative effects of short-term shareholders on employees and other stakeholders).

investments bear fruit thus constitutes a kind of exploitation or unfair opportunism, as it allows the corporation to accept those advantages without paying anything in exchange—all for the benefit of shareholders.[412] If directors owed employees fiduciary duties, the argument goes, employees would be able to sue directors for breaching such duties and therefore block such conduct.[413]

But how would this lawsuit play out? Assuming it did not die at the demand stage and employees were actually able to plead their case before a judge on the Delaware Court of Chancery, how would that judge review their claims? Recall that Delaware's most exacting standard of review, entire fairness, applies only when a director stands on both sides of a transaction and is thus especially prone to choosing her own self-interest above those of the corporation and its employees[414]—but obviously such self-interest is not present here, where the decision was made for the corporation and its shareholders. And even Delaware's intermediate standard of review, enhanced scrutiny, is triggered only when directors implement defensive measures or decide to sell a controlling stake in the corporation—again, neither of which are present here.[415] What is left then, is the standard of review that is notoriously deferential to directors, the business judgment rule: The decision will not be overturned so long as it was the product of good faith business judgment.[416] This means that unless the employee plaintiffs have some highly unusual, smoking gun–type evidence that shows the directors asleep at the switch or motivated by bad faith, the decision to outsource production will stand.[417]

So even in a world where directors owe fiduciary duties to employees, with a standard of conduct requiring them to act in employees' best interests, employees would not be able to protect

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[412] *See id.*

[413] *See* Lehr, *supra* note 31, at 106.

[414] *See supra* Section III.C; Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 459 (2011).

[415] Of course, one could imagine situations more relevant to employees that present the "omnipresent specter" of director self-interest and therefore merit judicial evaluation of the directors' action with enhanced scrutiny—such as directors setting the compensation arrangements at every level of the company, including their own—but, once again, the decision of where the company should source its production is surely not one of them. *Reis*, A.3d at 457.

[416] *See id.*

[417] *See id.*

themselves from directors' exploitative or opportunistic conduct because of the deferential standard of review.[418] To be clear, recall shareholders lack the power to compel directors to make any particular decisions, such as the described outsourcing, even when a very strong case could be made that the decision would result in a definitive shareholder benefit.[419] For both corporate constituencies, the result would be the same: directors retain nearly unimpeded authority over the business and affairs of the corporation.[420]

Perhaps recognizing the deference Delaware has long afforded to directors, other advocates of multi-stakeholder governance have focused less on substantive norms and more on procedural or process oriented norms they believe will benefit employees.[421] For example, Professor David Yosifon has argued:

> To make directors fiduciaries of workers and consumers, then, would be to say that because contract is insufficient to protect consumer interests and because the backstop of government regulation is implausible under shareholder primacy, directors must consider it their duty to "work hard and honestly" not only to advance shareholder interests, but worker and consumer interests as well.[422]

In other words, although Delaware law is "unrepentantly agnostic on substance," as Yosifon puts it, employees would benefit from the imposition of "procedural obligations on fiduciaries" that require anything "from reading reports, to hearing presentations, to engaging in discussion and debate. To require directors to attend as fiduciaries to the interests of workers and consumers at the level of firm governance would thus also provide workers and consumers with the benefits of the process obligation."[423]

Although procedural obligations in the interests of employees and customers are not meaningless, the fiduciary duty of care in Delaware already imposes a standard of conduct on directors that largely comports with what Yosifon is suggesting.[424]

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[418] *See id.*

[419] *See supra* notes 53–55 and accompanying text.

[420] *See supra* notes 55–56 and accompanying text.

[421] *See The Public Choice Problem*, *supra* note 17, at 1236; Lehr, *supra* note 31, at 133–34.

[422] *Id.* (quoting EASTERBROOK & FISCHEL, *supra* note 107, at 91).

[423] *The Public Choice Problem*, *supra* note 17, at 1236.

[424] *See id.*

As explained above, courts uphold the presumption of the business judgment rule only if a director has acted on an informed basis, which can be satisfied, as Professor Yosifon notes, by relying on reports of management and other advisors.[425] And even if these reports are primarily oriented toward securing shareholder profits (as Professor Yosifon supposes), they undoubtedly also convey which operational decisions directors should make to pursue such profits, and as such, the shareholders will present the relevant tradeoffs to the directors for consideration.[426]

Outsourcing is again a perfect example. The "informed basis" requirement under current Delaware law would require the director to know, at the very least, the total loss of personnel, if for no other reason than to calculate the savings in expenses and production costs.[427] But, what is more, most directors (and managers) already see themselves as having significant responsibilities to stakeholders like employees and customers, even if these are not fiduciary in nature.[428] Further, even the most cold-hearted capitalist would likely consider the reputational effects such action would have on the company and would thereby run through the "process obligations," if only to calculate potential blowback.[429] Thus, while directors may nonetheless proceed with outsourcing in the interests of shareholders, they would have no trouble satisfying their "process obligations" to employees before doing so, even under current law.[430]

But even on the premise that director fiduciary duties to employees would significantly increase the amount of process employees receive from directors,[431] how much protection would they

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[425] *See id.*

[426] *See id.*; *see* Eisenberg, *supra* note 189, at 438, 442–44.

[427] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[428] *See Director Primacy*, *supra* note 56, at 576 ("The 2000 edition of Korn/Ferry International's director survey found that when making corporate decisions, directors most frequently ranked shareholder interests as their primary concern, although it also found that a substantial number of directors feel a responsibility towards stakeholders.").

[429] *See The Public Choice Problem*, *supra* note 17, at 1236; Eisenberg, *supra* note 189, at 438, 442–44; KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES 162 (2006).

[430] *See The Public Choice Problem*, *supra* note 17, at 1236; Eisenberg, *supra* note 189, at 438, 442–44; GREENFIELD, *supra* note 429, at 162.

[431] *See The Public Choice Problem*, *supra* note 17, at 1236.

ultimately add? For the sake of argument, let's just assume employees get these obligations for free (meaning they give nothing up in return for the benefits). As Yosifon puts it, if the issue ex ante is that executives and shareholders really do hold all the economic power relative to other constituencies like employees,[432] would new process obligations to employees actually result in a meaningful number of companies foregoing the described outsourcing? More importantly, if a company like GM were to go ahead with the outsourcing anyway, what could employees do about it?

Even if Yosifon's proposed standard of conduct—"work hard and honestly" to serve the interests of workers—was conterminous with the standard of review, the substance of the decision is by definition completely out of bounds from judicial review.[433] That means directors could layoff large portions of their workforce so long as their decision was the product of hard and honest work—maybe the reports and presentations seen by the directors projected that continuing domestic production would result in an even bigger layoff in five years—and courts would find that their fiduciary obligations to employees had been satisfied.[434] In short, even if the employees gained the legal right to compel directors to work hard and honestly for them, it is highly unlikely this right would protect employees from the kind of "exploitative" or "opportunistic" conduct they are worried about.[435]

To be clear, the point is not that increased process obligations would result in no improvements for employees whatsoever. It may contribute to further cooperation between management and workers by establishing cultures of "fairness" and "legitimacy" surrounding the firm's decision-making processes.[436] It may even result in more efficient relational contracts between them, to the

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[432] *See id.* at 1236–37.

[433] *See id.*

[434] *See* Eisenberg, *supra* note 189, at 438, 442–44; *see, e.g.*, *supra* notes 355–57, 365–68 and accompanying text.

[435] *See* Eisenberg, *supra* note 189, at 438, 442–44; *see, e.g.*, *supra* notes 355–57, 365–68 and accompanying text.

[436] GREENFIELD, *supra* note 429, at 160–63. Indeed, Greenfield argues that what "really matters" is "procedural justice," such that the outcomes of such procedures—or "distributive justice"—are important mostly as a means to judge the procedures. *Id.* This Article agrees procedural fairness is important, but questions its superseding value when divorced from distributive concerns.

benefit of all corporate constituents.[437] But it is unwise to exaggerate these advantages.[438] If the whole point of expanding the class of constituents to whom directors owe of a duty of loyalty is to address the disparity of bargaining power between management and employees, it will not be much help to employees if the only added tool in their toolkit is the right to force the directors through yet another loosely defined process.[439] If the power disparity really is what Yosifon says it is, an added process obligation will barely slow directors (or shareholders) down.[440]

Unsurprisingly, this result would be even further compounded by Delaware's deferential standards of review.[441] If the directors made the decision to outsource in the absence of self-interest, Delaware courts would not intervene so long as the decision was otherwise the product of informed business judgement—just as they would not under current law.[442] The same is true for any other decision by directors not involving their own self-interest.[443] Thus, in virtually every imaginable corporate scenario, a newly imposed standard of conduct requiring directors

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[437] *Id.* at 166–70. Professor Greenfield bases his argument on "a growing body of scholarship ... that argues persuasively that relational, incomplete contracts are actually more efficient and socially optimal than contracts that are completely bargained and are full of terms and conditions." *Id.* at 167. However, he also acknowledges workers' contracts tend to be in the former category. *Id.* at 168. Thus, his account seems incomplete: more is needed to establish that the current level of trust between employer and employee—on which their incomplete contracts are currently supported—is not already the optimal level of trust for such relationships.

[438] *See, e.g.*, Macey, *supra* note 24, at 38.

[439] *See id.*

[440] *See id.* It appears that this is what Professor Jonathan Macey means when he says, "[t]his is what it means to have unequal bargaining power. Employers unable (due to minimum wage laws or other constraints) to reduce workers' wages or benefits simply will hire fewer workers. Thus, it is not possible to sustain the argument that imposing fiduciary duties will help workers who lack bargaining power; any lack of bargaining power on the part of the workers simply will manifest itself in some other way, such as in the form of a reduction in wages." *Id.*; s*ee also The Public Choice Problem*, *supra* note 17, at 1236.

[441] *See* Eisenberg, *supra* note 189, at 438, 442–44.

[442] *See supra* Section IV.A; *see also In re* Caremark Intern. Inc. Derivative Litigation, 698 A.2d 959, 967–68 (Del. Ch. 1996); Eisenberg, *supra* note 189, at 438, 442–44.

[443] *See* Eisenberg, *supra* note 189, at 438, 442–44.

to "work hard and honestly" for employees would provide nothing more than a negligible amount of additional protection for employees when there has not also been a change to the triggering conditions of Delaware's standards of review.[444]

In sum, directors' fiduciary duties to employees, whether substantive or procedural in content, would have almost no meaningful impact on how employees are treated vis-à-vis the other constituencies of the corporation.[445] Just as shareholders are powerless under current law to prevent corporate actions they believe unfairly favor employees at their expense, likewise would employees be powerless to prevent corporate actions in scenarios that they believe are reversed.[446] The same is true for creditors, customers, communities, the environment, et cetera—unless Delaware were to make major changes to its standard of review jurisprudence,[447] the extension of director fiduciary duties to these nonshareholder constituencies would do very little to address whatever vulnerability they may have to the corporation's pursuit of shareholder profit.[448]

Finally, none of this is to say Delaware's standards of review make fiduciary duties entirely useless or obsolete.[449] Recall both enhanced scrutiny and entire fairness serve important purposes depending on the context.[450] No doubt if directors owed fiduciary duties to employees, customers, creditors, or the like, they would be empowered to hold directors accountable the same ways shareholders do under current law.[451] What matters for the corporate social responsibility debate, however, is not whether directors can get away with serving themselves but whether they can get away with serving other constituencies in the normal course of business.[452] And for that purpose, the use of fiduciary duties has a very limited potential.[453]

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444 *See The Public Choice Problem*, *supra* note 17, at 1236; Eisenberg, *supra* note 189, at 440–41.

445 *See* Macey, *supra* note 24, at 38; Eisenberg, *supra* note 189, at 438, 442–44.

446 *See* Eisenberg, *supra* note 189, at 438, 442–44.

447 *See id.*; *supra* notes 356–58 and accompanying text.

448 *See supra* notes 386–87, 434–35 and accompanying text.

449 *See id.*

450 *See supra* notes 249–50, 253, 255, 258, 262, 319, 321, and accompanying text.

451 *See The Public Choice Problem*, *supra* note 17, at 1236–37.

452 *See* Eisenberg, *supra* note 189, at 438, 442–44.

453 *See id.*

C. Other Mechanisms for Nonshareholder Protection

One final point of clarification. This Article does not contend that nonshareholders like employees and customers have no reason to be dissatisfied with their portion under current corporate law simply because Delaware's standard of review is sufficiently deferential to allow directors to offer benefits to nonshareholders from time to time.[454] The point is merely that the deferential standard of review makes fiduciary duties the wrong tool to address whatever dissatisfaction nonshareholders do have.[455] And because Delaware's foundational principle of director authority over the business and affairs of the corporation is compelling as a matter of normative policy,[456] any attempt to modify the standard of review in addition to modifying the list of beneficiaries to whom directors owe fiduciary duties bears the burden of proving it would be neither unwise nor impractical.[457]

As such, scholars and practitioners who seek to protect the interests of a given corporate constituency—whether shareholders, employees, or otherwise—should look to other legal mechanisms to secure such protection.[458] Shareholders (and scholars who advocate on their behalf) would likely have better luck by implementing or improving incentive-based director compensation,[459] or strengthening the influence of independent directors.[460] Inversely, employees and their advocates would do well to focus their efforts on increasing the employees' role in corporate governance, and perhaps even seek to participate in the gains of the corporate enterprise.[461]

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[454] *See supra* notes 250, 401, 416, and accompanying text.

[455] *See supra* notes 386–87, 401–02, 407 and accompanying text.

[456] *See Business Judgment Rule*, *supra* note 38, at 86–87.

[457] *See supra* notes 403–07 and accompanying text.

[458] *See infra* notes 459–61 and accompanying text.

[459] *See, e.g.*, S. Burcu Avci et al., *Ending Executive Manipulations of Incentive Compensation*, 42 J. CORP. L. 277, 326 (2016).

[460] *See, e.g.*, Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 883–92 (1991).

[461] *See, e.g.*, Leo E. Strine, Jr. & Kirby M. Smith, *Toward Fair Gainsharing and a Quality Workplace for Employees: How a Reconceived Compensation Committee Might Help Make Corporations More Responsible Employers and Restore Faith in American Capitalism*, 76 BUS. LAW. 31, 33–34 (2020).

CONCLUSION

This Article has argued corporate fiduciary duties serve the very narrow purpose of preventing directors from improvidently benefiting from their role at the expense of shareholders or from committing gross lapses of care or good faith.[462] What this means is that the law can effectively use fiduciary duties to prevent a director's self-interested, negligent, or bad faith conduct—but, beyond that, the business judgment rule protects directors from shareholder liability, even when their decisions appear to favor other stakeholders.[463] The result is that fiduciary duties are a poor tool for regulating corporate directors' stakeholder interested conduct, such as those in which they distribute resources among the other nonbeneficiary corporate constituencies.[464] As such, nonshareholder constituencies like employees, customers, and communities have little to gain from becoming beneficiaries of the directors' fiduciary duties.[465] Those who wish to protect other constituencies from corporate externalities would do well to focus on different legal devices to secure such protection.[466]

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[462] *See supra* notes 69, 210 and accompanying text.
[463] *See supra* notes 355–57, 365–68 and accompanying text.
[464] *See supra* note 455 and accompanying text.
[465] *See supra* notes 452–53 and accompanying text.
[466] *See supra* notes 459–61 and accompanying text.