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THE ROLE OF ASPIRATION IN CORPORATE FIDUCIARY DUTIES

JULIAN VELASCO*

ABSTRACT

Corporate law is characterized by a pervasive divergence between standards of conduct and standards of review. Courts often opine on the relatively demanding standard of conduct, but their judgments must be based on the more forgiving standard of review. Commentators defend this state of affairs by insisting that it provides guidance to directors without imposing ruinous liability. However, the dichotomy can lead many, especially those who focus on the bottom line, to call into question the meaningfulness of standards of conduct. Of particular concern is the increasing popularity, in legal and scholarly circles, of the notion that fiduciary duty standards of conduct are aspirational and unenforceable. This theory, which I will call the “aspirational view,” is misguided. The use of the term “aspirational” is especially problematic. Whatever else “aspirational” may mean, it does not mean obligatory or mandatory. Whether by design or only by effect, the aspirational view has the potential to undermine fiduciary duties significantly. In this Article, I will argue that fiduciary duty standards of conduct are in fact duties—fully binding on actors even when they are not enforced. I will also argue that the unenforced duty is a meaningful concept because people obey the law for many different reasons, and not simply out of fear of punishment.

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INTRODUCTION

A peculiar characteristic of corporate law is the divergence of standards of conduct and standards of review.¹ Standards of conduct are rules of behavior that tell actors what is expected of them. Standards of review, on the other hand, are rules of decision that tell judges how to adjudicate cases. In many areas of law, the two types of standards coincide. For example, in tort law, the standard of conduct is ordinary care, and the standard of review is negligence, which is generally defined as the lack of ordinary care. Intuitively, it makes sense for actors to be judged by the standards with which they are expected to comply. However, the two types of standards need not align. In corporate law, they do not.

Corporate law is characterized by a pervasive divergence between standards of conduct and standards of review. For example, with respect to the duty of care, directors are expected to act with ordinary care, but judges will review their actions not for negligence, but for gross negligence.² Likewise, with respect to the duty of loyalty, directors are expected to act without conflicts of interests, but judges will review their actions for fairness, and only if there is a financial conflict of interest that rises to the level of self-dealing.³ It is similar for the duty of good faith: directors are expected to honestly pursue the interests of the corporation and its shareholders, but judges will review their actions for intentional misconduct.⁴ The wisdom of this divergence may be debatable, but its existence is not.

1. See generally Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993). Some scholars believe that the divergence should apply only to directors and not to officers. See, e.g., Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 440 (2005) (“[T]he business judgment rule ... does not and should not be extended to corporate officers in the same broad manner in which it is applied to directors.”). I take no position on this issue in this Article.

2. See *Smith v. Van Gorkom*, 488 A.2d 858, 874 (Del. 1985), *overruled on other grounds* by *Gantler v. Stephens*, 965 A.2d 695, 713 n.54 (Del. 2009).

3. Compare *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939), *with Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 363 (Del. 1993) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds* by *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000)).

4. See *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 62-68 (Del. 2006), *aff'g* 907 A.2d 693 (Del. Ch. 2005).

Courts often will speak of fiduciary duties in lofty terms but generally do not follow up with enforcement action. Ultimately, claims of breach of fiduciary duty rarely lead to liability for directors. This is a predictable consequence of the divergence. Courts often opine on the relatively demanding standard of conduct, but their judgments must be based on the more forgiving standard of review. Commentators defend this state of affairs by insisting that it provides guidance to directors without imposing ruinous liability.⁵ However, the dichotomy can lead many, especially those who focus on the bottom line, to call into question the meaningfulness of standards of conduct.

Of particular concern is the increasing popularity, in legal and scholarly circles, of the notion that fiduciary duty standards of conduct are aspirational and unenforceable. This theory, which I will call the “aspirational view,” is misguided. The use of the term “aspirational” is especially problematic. “Aspiration” is generally defined as “[a] strong desire for high achievement”⁶ or “[a] fervent hope, wish, or goal”;⁷ synonyms include “ambition,” “hope,” “dream,” and “ideal.”⁸ Perhaps the term is intended to elevate fiduciary duties by appealing to grand moral ideals. Its actual effect, however, is to debase fiduciary duties by rendering them optional and perhaps even unachievable. After all, whatever else “aspirational” may mean, it does not mean obligatory or mandatory. That standards of conduct are sometimes described not only as unenforced but unenforceable only reinforces this impression. I believe that the growing popularity of the aspirational view presents a dangerous development that ought to be arrested. Whether by design or only by effect, it has the potential to undermine fiduciary duties. To the extent

5. See *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697-98 (Del. Ch. 2005) (“Fiduciaries who act faithfully and honestly on behalf of those whose interests they represent are indeed granted wide latitude in their efforts to maximize shareholders’ investment.”), *aff’d*, 906 A.2d 27; Eisenberg, *supra* note 1, at 464-65 (“One explanation is that the law wants to send directors and officers a two-part message, as follows: ‘Your legal duty is to act with due care. At the same time, we want to give you a certain amount of running room so that you are not unduly risk averse or otherwise preoccupied with liability. Therefore, liability will normally be imposed upon you only if there is a clear variance between the conduct required by due care and your actual conduct.’”); see also *infra* notes 160-62 and accompanying text.

6. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 107 (4th ed. 2000).

7. ROGET’S II: THE NEW THESAURUS 54 (3d ed. 1995).

8. *Id.*

that fiduciary duties are not enforced by courts, they depend upon voluntary compliance. Presumably, greater compliance can be expected for mandatory rules than for optional ones.⁹ Thus, moving fiduciary duties from the former category into the latter likely would have negative consequences: if directors come to believe that standards of conduct are aspirational rather than mandatory, and therefore optional, they can be expected to reduce compliance over time.

In this Article, I will argue that the aspirational view is misguided and that fiduciary duty standards of conduct are *duties*—fully binding on actors even when they are not enforced. My argument will proceed as follows. In Part I, I will provide examples of the aspirational view in both judicial opinions and corporate law scholarship. In Part II, I will explore the justification for the divergence between standards of conduct and standards of review in corporate law. I will explore two theories: the acoustic separation theory, and what I call the room-for-error theory. Although the acoustic separation theory might support the aspirational view, it is deeply problematic and has not been adopted by the courts. The room-for-error theory is a more solid justification for the divergence and is the theory on which the courts and most scholars rely. This theory provides greater support for the mandatory view of fiduciary duties.

In Part III, I will argue that this divergence does not result in a bifurcation of fiduciary duties, as is commonly believed, but rather a tripartite division. First, standards of review create a minimum threshold for liability: conduct that is sufficiently egregious will lead to liability whereas less offensive conduct will not. Second, standards of conduct create a separate threshold: they distinguish between conduct that is required by law and conduct that is not. In other words, standards of conduct include behavior that is required by law but not legally enforced. Third, beyond standards of conduct, there is behavior that is praiseworthy and ought to be encouraged, but which the law does not specifically require. This, I will argue, is

9. See, e.g., Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943, 1032 (1995) (“Having the rule means that its enforcement flows not necessarily from the preference of the enforcer, but also possibly from an independent desire to conform to rules.”); see also *infra* Part IV.C.

the realm of aspiration. Best practices are a possible example: generally, fiduciaries ought to consider following best practices, but they are not necessarily required to do so. Thus, fiduciary duties are not bifurcated between standards that are enforced and those that are merely aspirational. Rather, there is a third category, which is often overlooked, that comprises standards that are required but not enforced.

In Part IV, I will defend this tripartite division and the mandatory view of fiduciary duties. First, I will argue that fiduciary duty standards of conduct are not inherently aspirational and unenforceable. Although courts, at times, describe fiduciary duties in lofty terms, they generally articulate standards of conduct that are quite mundane and perfectly enforceable. Second, I will defend the concept of the unenforced duty—which is, essentially, the heart of the standard of conduct. I will argue that it is a meaningful concept because people obey the law for many different reasons, and not simply out of fear of punishment. Finally, I will propose the view that fiduciary duties are not unenforced after all, but only imperfectly enforced—a fate shared by all laws.

As I hope to demonstrate, the fundamental flaw of the aspirational view is that it conflates unenforced duties with aspirational ideals. According to the aspirational view, a fiduciary's duty of care is merely to avoid gross negligence; to avoid negligence is merely aspirational. This is much too little to expect and demand of directors. Fiduciaries are supposed to be held to a higher standard because of their position of trust, but under this view, they are actually held to a much lower standard than the average person. Strangers generally owe each other a duty to avoid negligence, yet such conduct is considered aspirational for directors. This cannot be correct. For good reasons, we may not hold directors accountable for failure to meet the standard of conduct. However, we cannot pretend that the standard of review satisfies the role of the standard of conduct and that the standard of conduct is merely aspirational.

I. THE ASPIRATIONAL VIEW

The divergence between standards of conduct and standards of review in corporate law raises an important question: what are we

to make of standards of conduct? Standards of review are fairly straightforward: they are the law as enforced. But standards of conduct are not enforced. This can lead one to question what they represent.

There are two obvious, competing theories. The first I shall call the “mandatory view.” It maintains that standards of conduct are mandatory rules of law that are binding upon fiduciaries even if they are not legally enforced. A prominent proponent is Professor Melvin Eisenberg, whose work highlighted the divergence in corporate law. Despite the lack of enforcement, Eisenberg insists that “[s]tandards of conduct in corporation law are neither meaningless nor merely aspirational. Rather, they are legal rules intended to control behavior.”¹⁰ This is my position as well. I shall call the alternative theory the “aspirational view.” It does not consider standards of conduct to be law in the strict sense because they are not subject to legal enforcement. Standards of conduct are not seen as mandatory rules but rather as aspirational and unenforceable. As between the two theories, the mandatory view is the more traditional one. Corporate law has developed under the implicit assumption that standards of conduct are, in fact, law. The aspirational view is becoming increasingly popular, however, and it deserves attention.

In this Part, I will illustrate the aspirational view by reference to legal scholarship and judicial opinions. Unfortunately, the aspirational view remains somewhat inchoate, and no straightforward manifesto exists to illustrate it perfectly. Many of the authors may not be focused on the precise issue that is the subject of this Article. Moreover, much of the terminology at issue is inherently ambiguous. For example, even the key term, “standards of conduct,” is not limited to its meaning in the context of fiduciary duties; any norm can be considered a standard of conduct. Thus, we must review the writings of others with care. What follows is intended to be more illuminating than probative. Nevertheless, to varying degrees—even if not always intentionally—the writings discussed in this Part create the impression that compliance with fiduciary duty standards of conduct is not mandatory.

10. Eisenberg, *supra* note 1, at 464. Eisenberg rejects the contrary view as “reductionist.” *Id.* at 462-64.

A. Legal Scholarship

The aspirational view has its origins in academic legal scholarship and can best be illustrated by reference to it. The works of scholarship considered below are varied in nature. Some focus on the issue in depth, whereas others deal with it in passing. Likewise, some emphasize the aspirational nature of standards of conduct, and some emphasize their unenforceability. Although there is no single, clear statement of the aspirational view, it comes across to varying degrees in each of the following works.

An example in which the issue is dealt with more or less in passing can be found in an article written by Professor John Coffee.¹¹ In the article, Coffee confronts a perceived overuse of the criminal law and addresses the criminalization of fiduciary duty law through wire and mail fraud statutes.¹² In the course of the discussion, he describes the language of fiduciary duties as “soft-edged and aspirational.”¹³ He goes on to say that standards of conduct “can never be fully realized nor even defined with specificity in advance.”¹⁴ Although they may seem plausible enough in context, these claims are actually unsupported assertions. Moreover, they strongly suggest that standards of conduct are not only nonmandatory but also inappropriate for enforcement and possibly even unachievable ideals. Such casual statements are dangerous because they can be readily accepted, easily repeated, and even emphasized by others.¹⁵

A more thorough exploration of the issue can be found in the work of Professor Edward Rock. Rock has argued that corporate governance operates largely through informal and/or nonlegal sanctions.¹⁶ He notes that corporate law decisions “sometimes impose legal

11. John C. Coffee, Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models—And What Can Be Done About It*, 101 YALE L.J. 1875 (1992).

12. *Id.* at 1879.

13. *Id.*

14. *Id.*

15. See, e.g., Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 48, 88-90 (2010).

16. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997).

sanctions but surprisingly often do not.”¹⁷ Ultimately, “the principal sanction is not directly financial but reputational.”¹⁸ He also believes that judicial opinions on corporate law matters “can best be thought of as ‘corporate law sermons,’”¹⁹ and suggests that it would be better to “think of judges more as preachers than as policemen.”²⁰ Although Rock does not use the word “aspirational” to describe fiduciary duties, it is clearly the import of his theories. After all, the terms “sermons” and “preachers” sound much less mandatory than do “legal decisions” and “policemen.”

In another work, coauthored by Professor Michael Wachter, Rock has developed the argument further.²¹ Rock and Wachter claim that “the *raison d’être* of firms is to replace legal governance of relations with nonlegally enforceable governance mechanisms (what are sometimes called ‘norms’).”²² Under this view, “corporate law emerges as a remarkably sophisticated mechanism for facilitating self-governance by NLEERS”—that is, “nonlegally enforceable rules and standards.”²³ “In other words, in this model, the boundary of the firm is a jurisdictional boundary chosen by the participants.”²⁴ Thus, according to Rock and Wachter, fiduciary duties truly are, and ought to be, largely unenforceable.²⁵

In a recent article, Professors Claire Hill and Brett McDonnell have argued that “extra-legal forces, particularly non-binding pronouncements of the Delaware judiciary, are a critical adjunct to corporate law.”²⁶ According to them, “[l]aw, in its traditional sense, is ... not fully able to do what the corporation and its shareholders need it to do: make agents live up to their fiduciary duty to act with undivided loyalty to their principals.”²⁷ It is therefore necessary to

17. *Id.* at 1016.

18. *Id.* at 1012.

19. *Id.* at 1016.

20. *Id.*

21. Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619 (2001).

22. *Id.* at 1622.

23. *Id.* at 1623.

24. *Id.* at 1650.

25. To be fair, the authors do not entirely eliminate enforcement of fiduciary duties. They do believe in the need for a legally enforceable duty of loyalty. *See id.* at 1662.

26. Claire Hill & Brett McDonnell, *Executive Compensation and the Optimal Penumbra of Delaware Corporation Law*, 4 VA. L. & BUS. REV. 333, 335 (2009).

27. *Id.* at 352.

“invoke extra-legal forces such as reputation.”²⁸ This is done by means of what they call the “penumbra of Delaware corporate law,”²⁹ which they define as “extra-legal forces ... that extend[] Delaware corporate law significantly beyond law on the books as enforced.”³⁰ Included in the penumbra are “non-binding pronouncements of the Delaware judiciary”³¹—that is, standards of conduct.

Although they do not use the term, aspiration plays an important role in Hill and McDonnell’s theory. According to them, “what is ‘required’ or indeed routinely done on account of what is in the penumbra, is not the same as what is required and routinely done under law.”³² Although they believe that the penumbra operates as “an important influence on corporate director behavior”³³ through “reputational and norm-following mechanisms,”³⁴ they are not legally enforceable. Indeed, standards of conduct are explicitly labeled as “non-binding”³⁵ and are not considered “[l]aw, in its traditional sense.”³⁶ Thus, for Hill and McDonnell, compliance with standards of conduct seems much more aspirational than mandatory.

Finally, Professors Margaret Blair and Lynn Stout have done some important work on the issue of trust in corporate law.³⁷ Although they do not explicitly refer to fiduciary duties as aspirational, their work takes on this tenor. After a thorough exploration of the concept of trust and a review of the experimental evidence, the authors turn their attention to “three enduring puzzles in

28. *Id.*

29. *Id.* at 357.

30. *Id.* at 335. Other definitions or descriptions of the penumbra include the following: “the part of ‘law’ beyond law on the books and as enforced by judges that nevertheless influences the behavior of corporate actors, especially directors and officers,” *id.* at 357; “an important influence on corporate director behavior,” *id.* at 359; “including as it does ‘duties’ the violation of which would not yield a sanction,” *id.* at 360; “essentially, the law’s spirit,” *id.* at 364; “effectively consists of norms,” *id.*; “force influencing director behavior by means other than the imposition of liability or the threat thereof,” *id.* at 372.

31. *Id.* at 335.

32. *Id.* at 361.

33. *Id.* at 359.

34. *Id.* at 363.

35. *Id.* at 335.

36. *Id.* at 352.

37. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001).

corporate scholarship.”³⁸ First, on the “nature and meaning of the concept of fiduciary duty,” they conclude that “the essence of a fiduciary relationship is the legal expectation that the fiduciary will adopt the other-regarding preference function that is the hallmark of trustworthy behavior.”³⁹ Second, they explain the divergence between standards of conduct and standards of review⁴⁰ as follows: “By articulating a social expectation that directors will exercise due care, judicial opinions on the duty of care may influence directors’ behavior not so much by changing their external incentives as by changing their internal *preferences*.”⁴¹ Third, with respect to the role of trust and cooperation in corporate law, they conclude that “using legal rules, including contract, to discourage opportunistic behavior can, in some situations, be not only unnecessary but counterproductive, increasing the likelihood of the very sort of misbehavior against which it was intended to protect.”⁴²

Evident throughout the work is a shift in emphasis from the enforceable legal requirement to the internalized moral duty. In fact, they define trust as “internalized trust,” which does not include “calculative behavior motivated by external rewards or sanctions” of any kind, whether legal, market, or social in nature.⁴³ For them, internalized trust is “a taste or preference for behaving trustworthily”⁴⁴—essentially, a moral virtue. To the extent that Blair and Stout emphasize trust, they deemphasize law.⁴⁵ This is at least consistent with the aspirational view of fiduciary duties and probably also an argument against the mandatory view.

38. *Id.* at 1743.

39. *Id.*

40. They refer to the “second mystery of corporate law” as “the puzzling relationship between the corporate director’s duty of care and the business judgment rule.” *Id.*

41. *Id.* at 1744.

42. *Id.* at 1745.

43. *Id.* at 1750-51; *see also id.* at 1748-50 (“In this Article, we combine fear of retaliation, reputational loss, and social sanctions together under the label of market sanctions [S]uch motivations ... rely on a view of people as always strategic, calculating, and self-interested.” (emphasis omitted)).

44. *Id.* at 1750.

45. Of course, Blair and Stout do not reject law entirely. In fact, at least with respect to the duty of loyalty, they argue that fiduciary duties should not be seen as “default rules that can be freely contracted around.” *Id.* at 1782.

B. *The Disney Case*

The aspirational view of fiduciary duties has not yet worked its way into the law, but evidence of it can be found in some judicial opinions. The most important case in which this has happened is the *Disney* case. This case has led to many judicial opinions, three of which are especially relevant to the current discussion. The first, *Brehm v. Eisner*, is the first Delaware Supreme Court opinion in the case;⁴⁶ the second, *In re Walt Disney Co. Derivative Litigation*, is the chancery court's opinion after the trial;⁴⁷ the third, also titled *In re Walt Disney Co. Derivative Litigation*, is the Delaware Supreme Court's opinion upholding the trial court's decision.⁴⁸

The facts of the *Disney* case are well known and described at length in the various judicial opinions, so only a brief summary will be presented here. Michael Eisner was the CEO of Disney.⁴⁹ The company was looking for an eventual successor for Eisner, and he chose his friend, David Ovitz.⁵⁰ Ovitz's employment agreement provided that, if he were terminated without cause, he would receive essentially the full benefits of his employment contract.⁵¹ His employment with Disney did not work out very well, and, after only fourteen months, he was terminated without cause.⁵² As a result, he received a termination payment in excess of \$130 million.⁵³ Shareholders sued in a derivative action but were ultimately unsuccessful.⁵⁴

Throughout its first opinion in the case, the Delaware Supreme Court made various statements that reflect the aspirational view. Perhaps the most noteworthy passage is the following:

This is a case about whether there should be personal liability of the directors of a Delaware corporation to the corporation for lack of due care in the decision-making process and for waste of

46. 746 A.2d 244 (Del. 2000).

47. 907 A.2d 693 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

48. 906 A.2d 27 (Del. 2006), *aff'g* 907 A.2d 693.

49. *Brehm*, 746 A.2d at 250.

50. *Disney*, 906 A.2d at 36, 41.

51. *See Brehm*, 746 A.2d at 250.

52. *Id.* at 249, 252.

53. *Disney*, 906 A.2d at 35.

54. *Brehm*, 746 A.2d at 248.

corporate assets. This case is not about the failure of the directors to establish and carry out ideal corporate governance practices.

All good corporate governance practices include compliance with statutory law and case law establishing fiduciary duties. But the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate governance practices. Aspirational ideals of good corporate governance practices for boards of directors that go beyond the minimal legal requirements of the corporation law are highly desirable, often tend to benefit stockholders, sometimes reduce litigation and can usually help directors avoid liability. But they are not required by the corporation law and do not define standards of liability.⁵⁵

On its surface, this passage may seem unobjectionable. The court appears to be saying only that “[a]spirational ideals of good corporate governance practices ... are not required by the corporation law.”⁵⁶ This is obviously correct: the law cannot and should not mandate aspirational ideals. However, closer examination reveals that the court was doing more than merely stating the obvious.

For example, the court described the “legal requirements of the corporation law” as “minimal.”⁵⁷ Clearly, it must have been referring to the standard of review rather than the more expansive standard of conduct. Indeed, the court went on to state quite clearly that anything that goes beyond the “standards of liability” may be “highly desirable,” “benefi[cial],” and “help[ful],” but it is “not required by the corporation law.”⁵⁸ In other words, it is merely aspirational.

The significance of these statements is highlighted by the factual context of the case. The court dismissed the case on the pleadings even though it elsewhere admitted that this was “potentially a very troubling case on the merits,” and that, “both as to the processes ... and the waste test, this [wa]s a close case.”⁵⁹ For the facts to represent a “close case” with respect to the standard of review, they must have represented an easy case with respect to the standard of

55. *Id.* at 255-56.

56. *Id.* at 256.

57. *Id.*

58. *Id.*

59. *Id.* at 249.

conduct. The directors' conduct, as alleged, was fairly egregious.⁶⁰ Nevertheless, the court characterized it as a mere failure to comply with "[a]spirational ideals of good corporate governance practices."⁶¹ Although the court never explicitly stated that fiduciary duty standards of conduct are merely aspirational, it was obviously of that opinion.

The plaintiffs in the *Disney* case were given leave to amend the pleadings⁶² and eventually were able to obtain a trial on the merits.⁶³ Ultimately, the court found in favor of the defendants.⁶⁴ In its opinion after the trial, the chancery court also opined on the role of aspiration in the law of fiduciary duties. Again, the most noteworthy passage is the following:

Unlike ideals of corporate governance, a fiduciary's duties do not change over time. How we understand those duties may evolve and become refined, but the duties themselves have not changed, except to the extent that fulfilling a fiduciary duty requires obedience to other positive law. This Court strongly encourages directors and officers to employ best practices, as those practices are understood at the time a corporate decision is taken. But Delaware law does not—indeed, the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices, any more than a common-law court deciding a medical malpractice dispute can impose a standard of liability based on ideal—rather than competent or standard—medical treatment practices, lest the average medical practitioner be found inevitably derelict.

Fiduciaries are held by the common law to a high standard in fulfilling their stewardship over the assets of others, a standard that (depending on the circumstances) may not be the same as that contemplated by ideal corporate governance. Yet therein lies perhaps the greatest strength of Delaware's corporation law. Fiduciaries who act faithfully and honestly on behalf of those whose interests they represent are indeed granted wide latitude

60. *See id.* at 267.

61. *Id.* at 256.

62. *Id.* at 267.

63. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

64. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 35-36 (Del. 2006), *aff'g* 907 A.2d 693.

in their efforts to maximize shareholders' investment. Times may change, but fiduciary duties do not. Indeed, other institutions may develop, pronounce and urge adherence to ideals of corporate best practices. But the development of aspirational ideals, however worthy as goals for human behavior, should not work to distort the legal requirements by which human behavior is actually measured.⁶⁵

This language is very different than that of the Delaware Supreme Court. There is no talk of "minimal legal requirements."⁶⁶ To the contrary, the court acknowledged that fiduciary duties impose a "high standard," which "(depending on the circumstances) may not be the same [standard] as that contemplated by ideal corporate governance."⁶⁷

The aspirational view of fiduciary duties is nevertheless evident in the court's opinion. When the court spoke of "the legal requirements by which human behavior is actually measured,"⁶⁸ it was referring to standards of review. Everything else, including standards of conduct, is lumped together as "aspirational ideal[s] of best practices."⁶⁹ Although the court "strongly encourage[d] directors and officers to employ best practices, as those practices are understood at the time a corporate decision is taken," it could not "hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices."⁷⁰ Again, this is true even though the court specifically acknowledged that "there [were] many aspects of [the] defendants' conduct that fell significantly short of the best practices of ideal corporate governance."⁷¹ The court clearly believed that standards of conduct are merely aspirational. When the court asserted that directors would "be found inevitably derelict"⁷² if they were held liable for aspirational ideals, it was suggesting that standards of conduct are not only unenforceable, but even unachievable.

65. *Disney*, 907 A.2d at 697-98.

66. *Brehm*, 746 A.2d at 256.

67. *Disney*, 907 A.2d at 697.

68. *Id.* at 698.

69. *Id.* at 697.

70. *Id.*

71. *Id.*

72. *Id.*

Moreover, the court made the unnecessary and questionable assertion that fiduciary duties “do not change over time.”⁷³ Because the court also said that “the development of aspirational ideals ... should not work to distort the legal requirements by which human behavior is actually measured,”⁷⁴ it seems the court believed that standards of review do not change over time. If this assertion were true, it would limit the reach of fiduciary duties considerably. The context of the assertion is also particularly significant. The court elsewhere explicitly acknowledged that societal expectations were changing as a result of the then-recent financial scandals at companies such as Enron and WorldCom.⁷⁵ Yet rather than point out that the conduct in *Disney* occurred before those scandals and therefore should not be judged by subsequent standards, the court insisted that fiduciary duties are unchanging. According to the court, the ever-increasing societal expectations of directors have no legal significance. In other words, standards of conduct remain aspirational forever.

On the final appeal, the Delaware Supreme Court upheld the trial court’s decision.⁷⁶ Its opinion is fundamentally in line with the others. A particularly noteworthy passage is the following:

In our view, a helpful approach is to compare what actually happened here to what would have occurred had the committee followed a “best practices” (or “best case”) scenario, from a process standpoint....

Had that scenario been followed, there would be no dispute (and no basis for litigation) over what information was furnished to the committee members or when it was furnished. Regrettably, the committee’s informational and decisionmaking process used here was not so tidy. That is one reason why the Chancellor found that although the committee’s process did not fall below the level required for a proper exercise of due care, it did fall short of what best practices would have counseled.⁷⁷

73. *Id.*

74. *Id.* at 698.

75. *Id.* at 697.

76. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 35-36 (Del. 2006), *aff’g* 907 A.2d 693 (Del. Ch. 2005).

77. *Id.* at 56.

Although the court's opinion never used the term "aspirational" and did not explicitly discuss standards of conduct and standards of review together, the aspirational view is evident throughout. When the court stated that "the committee's process did not fall below the level required for a proper exercise of due care," it was clearly referring to the standard of review. When the court said that "the committee's process ... f[e]ll short of what best practices would have counseled" and, elsewhere, that it "fell *far* short,"⁷⁸ we can conclude that it did not satisfy the standard of conduct. The court, unfortunately, went on to say that the directors "breached no duty of care"⁷⁹ and had performed "adequately."⁸⁰ With respect to Eisner's conduct, the court used similar language: "Even though the Chancellor found much to criticize in Eisner's 'imperial CEO' style of governance, ... in the end, Eisner's conduct satisfied the standards required of him as a fiduciary."⁸¹ Obviously, the court believes that standards of conduct are not mandatory; they are aspirational.

C. Judges Writing Extrajudicially

It is not uncommon for Delaware judges to engage in extrajudicial scholarship. The extent to which such scholarship should be used as an interpretive tool to help understand opinions written by such judges is an interesting question. There is no doubt, though, that judges writing off the bench can have a significant influence. In this Section, I will consider the writings of two important judges: the Honorable Norman Veasey, the former Chief Justice of the Delaware Supreme Court, and the Honorable William Allen, one of the most highly respected Chancellors in the history of the Delaware Chancery Court.⁸²

Not surprisingly, Veasey's extrajudicial writings echo the opinion he authored for *Brehm v. Eisner*. For example, he insists that "the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate

78. *Id.* at 55 (emphasis added).

79. *Id.*

80. *Id.* at 56, 58, 60, 72.

81. *Id.* at 73.

82. See, e.g., Mark J. Loewenstein, *Delaware as Demon: Twenty-Five Years After Professor Cary's Polemic*, 71 U. COLO. L. REV. 497, 513 (2000).

governance practices.”⁸³ Throughout his writings, he is able to go into greater detail on the matter. On various occasions, he has written about the divergence between standards of conduct and standards of review, which he acknowledges “is implied in Delaware jurisprudence ... but is not well developed in the cases.”⁸⁴

For Veasey, standards of review are “the standards applied by courts to determine whether directors will be held liable for wrongdoing,”⁸⁵ and standards of conduct are “the normative means, or best practices, by which directors should fulfill their functions.”⁸⁶ Because standards of conduct do not necessarily lead to liability,⁸⁷ he often refers to them as aspirational.⁸⁸ Unlike the trial court in

83. E. Norman Veasey, *Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2188-89 (2001).

84. E. Norman Veasey with Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004?*, 153 U. PA. L. REV. 1399, 1416-17 (2005).

85. E. Norman Veasey, *Weil Briefing: Corporate Governance, NACD Blue Ribbon Commission Seeks to Clarify Liability Concerns and Private Preventative Guidance to Directors*, 1543 PRACTICING L. INST.: CORP. L. & PRAC. COURSE HANDBOOK SERIES 531, 533 (May 2006); *see also* Veasey with Di Guglielmo, *supra* note 84, at 1416 (“Standards of review ... govern whether directors will be held liable or [whether] a transaction [will be] set aside as a result of particular action or inaction.”).

86. Veasey, *supra* note 85.

87. Veasey acknowledges that failure to comply with standards of conduct *can* lead to liability—if it also amounts to a failure to comply with the standards of review. *See, e.g.*, Veasey with Di Guglielmo, *supra* note 84, at 1436 (“But in some circumstances, an egregious failure to adhere to certain evolving expectations could result in liability upon the application of the appropriate standard of review.”). This is because standards of conduct encompass standards of liability. *See* Veasey, *supra* note 85, at 536 (discussing “the distinction between ‘compliance with fiduciary duties’ and ‘best practices of corporate governance’: the latter includes the former, but the former does not necessarily include the latter”). As Veasey notes, “standards of conduct ... are defined by Delaware statutory law and judge-made articulations of fiduciary duties,” Veasey with Di Guglielmo, *supra* note 84, at 1405, and “include conduct that is required of directors and aspirations for what is expected of directors,” *id.* at 1416.

88. *See, e.g.*, E. Norman Veasey, *The Challenges for Directors in Piloting Through State and Federal Standards in the Maelstrom of Risk Management*, The Directors’ Academy Keynote Address, Seattle University (June 4, 2010), in 34 SEATTLE U. L. REV. 1, 9 (2010) (“The standards of conduct are aspirational.”); E. Norman Veasey, *Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics, and Federalism*, 152 U. PA. L. REV. 1007, 1008 (2003) [hereinafter Veasey, *Musings*] (“Liability may or may not follow a failure to live up to these aspirational standards.”); E. Norman Veasey, *Reflections on Key Issues of the Professional Responsibilities of Corporate Lawyers in the Twenty-First Century*, 12 WASH. U. J.L. & POL’Y 1, 5 (2003) (“Standards of conduct are the aspirational standards that directors should follow in carrying out their responsibilities to either manage or direct the management of the corporation’s business and affairs.”); Veasey with Di Guglielmo, *supra* note 84, at 1436 (“A priori, these evolving expectations may be largely aspirational standards of conduct.”). *But see* Veasey, *Musings*,

Disney, however, Veasey acknowledges that there can be some interaction between standards of conduct and standards of review:

[C]orporate law does, I believe, inform good corporate practices....

The same may be true in reverse. That is, modern trends in good corporate governance may become such well-established norms that the failure to follow the trends could conceivably result in liability in an egregious case. So good corporate practice may inform corporate law.⁸⁹

Ultimately, Veasey believes that fiduciary duties are “dynamic, not static.”⁹⁰ According to him, “The legal determination whether directors have acted in accordance with these fiduciary principles may change as extralegal expectations for directorial conduct change.”⁹¹ Veasey generally believes that “[c]odes of best practices ... —not judicial fiat—are the appropriate intracorporate vehicle” for reform.⁹² Nevertheless, he also believes that “judges can and should perform a service by speaking out to encourage best corporate practices that could have a prophylactic benefit in minimizing the exposure of directors to liability.”⁹³ He has offered a list of seven suggestions for good corporate practice, but has been explicit in stating that they are “offered as an aspirational matter only.”⁹⁴

Chancellor Allen has also expressed opinions consistent with the aspirational view of fiduciary duties. According to him, the law of

supra, at 1010-11 (“[T]he [exculpation] statute does not eliminate due care as a standard of conduct, thus leaving it not only as an aspirational goal, but also an expectation. A breach of the duty of care can be a basis for equitable relief.”).

89. Veasey, *supra* note 83, at 2189; *see also* Veasey with Di Guglielmo, *supra* note 84, at 1436.

90. Veasey with Di Guglielmo, *supra* note 84, at 1436. This seems inconsistent with the *Disney* chancery court opinion, which stated that fiduciary duties do not change over time. *See supra* note 65 and accompanying text. However, one could interpret Veasey’s language as offering more of a theoretical possibility than a real one: even the short passage above is liberally sprinkled with qualifiers such as “may,” “could conceivably,” and “in an egregious case.” Veasey, *supra* note 83, at 2189.

91. Veasey with Di Guglielmo, *supra* note 84, at 1439; *see also id.* at 1436 (“It does seem obvious to me ... that the expectations of director processes—both by stockholders and courts— ... continually evolve as business realities and mores change over time. The courts apply the quintessential common law process to those evolving expectations.”).

92. Veasey, *supra* note 83, at 2183.

93. *Id.* at 2181.

94. *Id.* at 2190; *see also id.* at 2190-91.

fiduciary duties can be seen “*as an expression of community ideals* designed to inspire solidarity around certain values.”⁹⁵ He suggests that “the duty of care [is] essentially aspirational: informing well-intentioned persons of what they should be doing in a most general way.”⁹⁶ For Allen, this does not render fiduciary duties meaningless. This is because, Oliver Wendell Holmes’s “bad man” philosophy notwithstanding,⁹⁷ people generally “obey law for reasons not fully accounted for by ... utilitarian calculus.”⁹⁸ According to Allen, “there is some virtue to the judicial articulation of nonenforceable standards of conduct” because “most human beings place value on thinking of themselves as moral actors who live up to societal expectations.”⁹⁹ He concludes that aspirational fiduciary duties can affect director behavior without an explicit enforcement mechanism.

In two works coauthored with Vice Chancellors Jack B. Jacobs—later made a Delaware Supreme Court Justice—and Leo E. Strine, Jr., Allen has also suggested that standards of conduct are aspirational. In two separate articles, when discussing differences between standards of conduct and standards of review, the authors refer to standards of conduct, in passing, as “aspirational.”¹⁰⁰ The lack of discussion suggests that they believe the characterization to be obvious and noncontroversial. At the very least, it can lead the reader to that conclusion.

95. William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Corporate Law*, in *COMPARATIVE CORPORATE GOVERNANCE* 307, 329 (Klaus J. Hopt et al. eds., 1998).

96. *Id.*

97. O.W. Holmes, *The Path of the Law*, 10 *HARV. L. REV.* 457, 459 (1897) (“If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.”).

98. Allen, *supra* note 95, at 329 (emphasis omitted).

99. William T. Allen et al., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny as a Standard of Review Problem*, 96 *NW. U. L. REV.* 449, 460 n.40 (2002); *see also* Allen, *supra* note 95, at 330 (“[H]uman actors are not only opportunistic, they are also members of *moral communities* with allegiances to *moral codes*.”).

100. Allen et al., *supra* note 99, at 460; William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporate Law*, 56 *BUS. LAW.* 1287, 1301 (2001).

II. WHY THE DIVERGENCE?

At the heart of the aspirational view of fiduciary duties—that is, the theory that standards of conduct are aspirational and unenforceable—is the divergence between standards of conduct and standards of review in corporate law. In order to determine whether the aspirational view is a sensible interpretation of this divergence, we must understand why the divergence exists in the first place. In this Part, I will consider the two main theories that may explain the divergence. First, I will consider the “acoustic separation” theory, proposed by Professor Meir Dan-Cohen, which posits that the law may wish to say different things to different audiences.¹⁰¹ Next, I will consider what I call the “room-for-error” theory, which provides the justification for the business judgment rule. I will argue that, whereas the acoustic separation theory may provide more support for the aspirational view, the room-for-error theory is more compatible with the mandatory view. Because corporate law has coalesced around the room-for-error theory, the mandatory view seems a more appropriate interpretation of the divergence than the aspirational view.

Before turning to these theories, however, it is worth noting, if only briefly, the types of reasons that are *not* given for the divergence. The divergence is not said to exist because of the relative unimportance of standards of conduct. Neither scholars nor courts argue that fiduciary duties are relatively unimportant and unworthy of additional enforcement. Nor do they argue that compliance with standards of conduct is unimportant, or that compliance at the level of standards of review is all that is necessary. To the contrary, in a world of never-ending financial crises and scandals, the importance of good behavior is appreciated all too well. What they believe is that there are better ways to balance compliance with other goals than through greater legal enforcement. Of course, if fiduciary duties were considered relatively insignificant, then the aspirational view would make perfect sense. The fact that they are

101. Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984); see also JEREMY BENTHAM, A FRAGMENT ON GOVERNMENT AND AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION 430 (Wilfrid Harrison ed., 1948) (cited in Dan-Cohen, *supra*, at 626-27).

considered terribly important adds to the credibility of the mandatory view.¹⁰²

A. Acoustic Separation

One possible explanation for the divergence was proposed by Meir Dan-Cohen.¹⁰³ Although his particular focus was on criminal law rather than corporate law, the relevant principles could apply to any area of law. Dan-Cohen recognizes a distinction between what he calls “conduct rules” and “decision rules”¹⁰⁴—which correspond to standards of conduct and standards of review, respectively, in corporate law. He argues that, although these types of rules generally correspond, they need not do so and could diverge.¹⁰⁵ The reason they might diverge, he suggests, is so that the law can say different things to different audiences. In particular, the law may wish to say one thing to the general population about the criminal law, and something different to the courts.¹⁰⁶

One example that Dan-Cohen relies upon is the duress defense.¹⁰⁷ He suggests that, when the law is speaking to the general population, it should emphasize the importance of compliance with the law; however, when the law is speaking to the courts, it may wish to make allowances for cases involving duress.¹⁰⁸ According to Dan-Cohen, perhaps the general public should not be informed about this defense because it might lead to suboptimal resistance to coercion or to excessive claims of duress.¹⁰⁹ Thus, the divergence between conduct rules and decision rules could lead to maximum compliance with the law while simultaneously providing for humane exceptions.¹¹⁰

102. The view discussed above—that fiduciary duty standards of conduct are unimportant and unworthy of enforcement—could be called the “irrelevance” theory. It is not discussed alongside the acoustic separation and room-for-error theories because it has no traction.

103. Dan-Cohen, *supra* note 101.

104. *Id.* at 627.

105. *Id.* at 629.

106. *Id.* at 630.

107. *Id.* at 632-34.

108. *Id.* at 633.

109. *See id.* at 670.

110. *Id.* at 633-34.

The theory of acoustic separation could provide some support for the aspirational view. It is consistent with the notion that conduct rules—that is, standards of conduct—are not meant to be enforced and thus are arguably aspirational. If this were the basis for the divergence in corporate law, then perhaps the aspirational view would be on solid ground. However, the theory is deeply problematic.

There are two types of objections to the acoustic separation theory: one descriptive and one normative. As a descriptive matter, this theory depends upon an acoustic separation that simply may not exist. By “acoustic separation,” Dan-Cohen means that the law would be able to speak to different audiences without each hearing what the law says to the others.¹¹¹ Clearly these conditions do not obtain in reality. Dan-Cohen understands the problem, but argues that it is plausible to believe that a partial separation exists and that therefore this justification might retain some validity.¹¹²

Personally, I am skeptical that any meaningful acoustic separation can exist over the long run. In a democratic society, the law cannot be hidden. The relevant audience eventually will come to understand the applicable law, at least generally. However, even if a partial acoustic separation may exist with respect to the general population and criminal law, it is especially unlikely to obtain with respect to directors and corporate law. Directors are sophisticated parties with access to legal counsel. For major transactions and other situations that are most likely to lead to litigation, directors generally have the advice of expert counsel. These attorneys are paid very well to ensure that directors are well informed of their options under the law. That directors could somehow be uninformed about standards of review is implausible.¹¹³

Dan-Cohen argues that standards of conduct, which are directed at the general population, are simpler to understand than standards of review, which are directed at legal experts.¹¹⁴ However, lawyers

111. *See id.* at 630.

112. *See id.* at 634-36.

113. For an interesting take on selective transmission, see Lyman Johnson, *Counter-Narrative in Corporate Law: Saints and Sinners, Apostles and Epistles*, 2009 MICH. ST. L. REV. 847, 850 (arguing that, although courts of equity attempt to “preach” to corporate management, the moral message may be lost when mediated through corporate attorneys).

114. Dan-Cohen, *supra* note 101, at 652; *see also* Eisenberg, *supra* note 1, at 466-67 (hypothesizing the effects of partial acoustic separation on “primary actors”).

flatter themselves if they believe that only they can understand the concepts involved. Corporate directors are not simpletons. Standards of review, moreover, generally are quite simple in corporate law.¹¹⁵ For example, one of the most basic principles of corporate law is the business judgment rule—a decision rule which provides directors with an extraordinary degree of protection from liability.¹¹⁶ Fairness¹¹⁷ and intentional misconduct¹¹⁸ are not especially complex, either. Similarly, directors are fully aware of exculpation charter provisions, which create decision rules that further limit their exposure to liability.¹¹⁹ It seems likely that directors often may know *more* about the standards of review than about the standards of conduct.¹²⁰ As a result, it is difficult to believe that there is any meaningful acoustic separation in corporate law.

The more significant objections to the acoustic separation theory are normative. Professor Richard Singer has dealt with these issues extensively.¹²¹ For present purposes, I wish to highlight two general

115. At times, corporate law can get sufficiently complex that it would be unreasonable to expect directors to be aware of all the details. *See* Allen et al., *supra* note 100, at 1292 (arguing against “protean growth,” and in favor of simplification, of the corporate law of fiduciary duties). That is why they hire lawyers. However, as a general matter, corporate law standards of review tend to be rather simple.

116. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

117. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

118. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63-67 (Del. 2006), *aff’g* 907 A.2d 693 (Del. Ch. 2005).

119. DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

120. Eisenberg argues that “prudent lawyers who are asked to give advice to clients concerning a proposed course of action are likely to give advice based on the rules of conduct, not on the rules of review.” Eisenberg, *supra* note 1, at 464. This assertion is made without any supporting evidence, and for a variety of reasons, it does not seem very plausible. Lawyers, who are conservative by nature, may well urge caution on their clients. However, limiting discussions with clients to the standards of conduct would be borderline malpractice, and sophisticated directors would not be content with simplistic answers to difficult questions. If, as Eisenberg admits, “from the perspective of an actor proposing to engage in certain conduct, standards of conduct are ‘safe’ rules and standards of review are ‘risky’ rules,” *id.*, then directors will want to understand the law so that they, rather than their attorneys, can decide on how much risk to take. In fact, one of the most basic things that the law of fiduciary duties requires of directors is that they become informed before making decisions. Thus, it is extremely unlikely that directors will be willing or able to maintain any meaningful acoustic separation. As for whether they will be willing to skate close to the standard of review, it is worth noting that directors, as entrepreneurs by nature, may be less conservative than their attorneys.

121. Richard Singer, *On Classism and Dissonance in the Criminal Law: A Reply to*

considerations. First, although acoustic separation—and the selective transmission that makes it possible¹²²—may be interesting as a theoretical construct, it is not desirable for a democratic society.¹²³ As Dan-Cohen himself admits, “[T]he sight of law tainted with duplicity and concealment is not pretty.”¹²⁴ Nevertheless, he insists that acoustic separation does not necessarily depend upon “deliberate, purposeful human action,” or “a conspiracy view of lawmaking in which legislators, judges, and other decisionmakers plot strategies for segregating their normative communications more effectively.”¹²⁵ His efforts on this front, though, are halfhearted and not very convincing. The fact remains that acoustic separation is normatively very problematic.

Second, acoustic separation is unfair from the perspective of the actor. According to Dan-Cohen, “When decision rules are more lenient than relevant conduct rules, as in our duress example, no one is likely to complain about the frustration of an expectation of punishment.”¹²⁶ This assertion is simply wrong. A person who refuses to succumb to coercion can be expected to complain in frustration when he learns that he could have relied on the secret defense of duress.¹²⁷ Dan-Cohen claims that “[a]n individual who would not have committed an offense but for his knowledge of the existence of such a defense” essentially “admits to being the Holmesian ‘bad man,’ who acts out of fear of legal sanctions rather than out of deference to his duties,” and suggests that his concerns do not deserve respect.¹²⁸ However, this is an oversimplified assessment. People who resist coercion or duress often do so at great personal cost. Why should they make such sacrifices if society does not truly expect it of them? The same fairness concerns that motivate the availability of the defense in the first place suggest that those to whom it should apply ought to be made aware of its

Professor Meir Dan-Cohen, 77 J. CRIM. L. & CRIMINOLOGY 69, 84-100 (1986).

122. See Dan-Cohen, *supra* note 101, at 634-36. Dan-Cohen defines “selective transmission” simply as “the transmission of different normative messages to officials and to the general public.” *Id.* at 635.

123. Singer, *supra* note 121, at 86.

124. Dan-Cohen, *supra* note 101, at 673.

125. *Id.* at 635.

126. *Id.* at 634.

127. Singer, *supra* note 121, at 99.

128. Dan-Cohen, *supra* note 101, at 671.

existence—and this is true even though others who become aware of the defense may falsely claim it. Hiding relevant considerations from actors seems inappropriate. Dan-Cohen suggests that any calculus as to the costs and benefits of compliance with law is inappropriate, but does not provide a convincing account of why that is so.

Regardless of whether one finds the acoustic separation theory convincing, the fact remains that the theory has not gained much traction in corporate law. Although it may be discussed, and occasionally approved, by corporate law scholars, it is not relied on very heavily. More importantly, it has not gained acceptance in the courts. The next Section considers the justification upon which the courts and most scholars rely.

Although the acoustic separation theory has not gained any significant traction, a related theory might seem more respectable. It is often said that the law of corporate fiduciary duties is ambiguous.¹²⁹ One could argue that this ambiguity has a positive effect on compliance: because fiduciaries cannot be sure whether their conduct will lead to liability, they will be more cautious than they would in the face of a clear rule.¹³⁰

This claim must be assessed on both a descriptive and normative level. Descriptively, we must first ask whether the law of corporate fiduciary duties can meaningfully be described as ambiguous. There is widespread agreement that the law is ambiguous, and legal

129. See, e.g., William T. Allen, *Ambiguity in Corporation Law*, 22 DEL. J. CORP. L. 894 (1997).

130. See, e.g., Mohsen Manesh, *Indeterminacy and Self-Enforcement: A Defense of Delaware's Approach to Director Independence in Derivative Litigation*, 6 J. BUS. & SEC. L. 177, 197-98 (2006) (“[T]he *theoretical risk* imposed by indeterminacy promotes a self-policing norm that will *actually* reduce litigation and judicial intervention.”); cf. Allen, *supra* note 129, at 898 (“Clear, ‘hard and fast’ legal rules ... create[] the risk that agents—such as corporate management—might deploy such well-defined rules cleverly (and technically correctly), but with the purpose in mind not to advance long-term interests of investors, but to pursue some different purpose.”); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1083 (2000) (“[M]uddy rules can reduce the incentives to engage in strategic behavior.”); D. Gordon Smith, *A Proposal to Eliminate Director Standards from the Model Business Corporation Act*, 67 U. CIN. L. REV. 1201, 1208-09 (1999) (“[T]he cases implicating the duty of care are so highly contextual that the standard of conduct is not easily distinguishable from the standard of liability. The two become conflated in a web of facts, thus permitting judges a wide degree of latitude in future cases, which in turn encourages directors to exercise high levels of diligence.”).

scholars generally view this situation very negatively.¹³¹ However, I am skeptical of such claims.¹³² On the one hand, it seems difficult to imagine how the law of fiduciary duties could be more precise. After all, fiduciary duties are essentially matters of equity rather than law.¹³³ On the other hand, if one is looking for a safe harbor of sorts,¹³⁴ then it is difficult to imagine a safer harbor than the one provided by the business judgment rule.¹³⁵ A cynic might insist that the law is clear: directors always win. The cynic would be wrong, of course, but not necessarily far off the mark. The fact is that directors generally know exactly how to escape liability; but rather than play it safe, they often want to push the limits. It is only at the boundaries that the law is indeterminate—and that, of course, is unavoidable. Take, for example, the duty of loyalty: if directors avoid self-dealing, they will not be subject to the entire fairness test.¹³⁶ It is only when they insist upon self-dealing that they are subject to the indeterminacy of having to prove the fairness of their conduct.¹³⁷ Hostile takeover situations may be more complicated because directors cannot avoid the inherent conflict.¹³⁸ Directors

131. See, e.g., Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909-10 (1998). See generally Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 221-24 (2011) (outlining the negative effects of indeterminacy in Delaware corporate law product, especially on sister states' law products).

132. Cf. Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1280 (2001) (“[T]he cries of indeterminacy from sophisticated corporate practitioners strike me as somewhat exaggerated.”).

133. See *Uni-Marts, Inc. v. Stein*, Nos. 14713, 14893, 1996 WL 466961, at *9 (Del. Ch. Aug. 12, 1996) (“[T]he essential fiduciary analysis component of corporation law is not formal but substantive.”); *Speiser v. Baker*, 525 A.2d 1001, 1011 (Del. Ch. 1987) (“[O]ur law is the polar opposite of technical and literal when the fiduciary duties of corporate officers and directors are involved.”); see also Veasey with Di Guglielmo, *supra* note 84, at 1413 (“Fiduciary law is based on equitable principles. Thus, it is both inherently and usefully indeterminate.”).

134. *But see, e.g.,* Kamar, *supra* note 131, at 1921 (“Delaware law offers no safe harbors, compliance with which would preclude judicial review and reduce uncertainty.”).

135. See *infra* notes 141-55 and accompanying text.

136. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) (“[T]he intrinsic fairness standard ... will be applied only when the fiduciary duty is accompanied by self-dealing—the situation when a [fiduciary] is on both sides of a transaction with its [beneficiary].”).

137. See *id.* A similar analysis could be made with respect to other fiduciary duties. See *infra* notes 160-67 and accompanying text.

138. Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 875 (2004).

could avoid any risk of liability, however, by not resisting the wishes of the shareholders.¹³⁹ It is unfair to describe the law as indeterminate under such circumstances. Finally, litigation generally will be about the gray areas of the law, because few will bother to litigate a matter that is settled. Looking at the case law in almost any area will suggest a significant amount of indeterminacy. Perhaps, then, all law is indeterminate. Accordingly, as a descriptive matter, it is not fair or meaningful to make the claim about the law of corporate fiduciary duties in particular.

As a normative matter, we must ask whether ambiguity or indeterminacy is a good thing. To the extent that the ambiguity is inescapable, it does not much matter. All that can be done is to note the good and bad side effects and try to manage them. To the extent that the ambiguity is intentional, however, the normative issue becomes more important. In that case, ambiguity becomes almost indistinguishable from acoustic separation: to keep the law ambiguous in order to foster the desired behavior is akin to hiding the law so that people will act out of ignorance. The same factors that make acoustic separation distasteful also make ambiguity distasteful; the difference is simply one of degree. To the extent that corporate law is ambiguous, it may lead to greater “compliance”—if it may be called that—but this is not necessarily a good thing.

B. Room for Error

In corporate law, as opposed to legal scholarship, the divergence between standards of conduct and standards of review is not exactly a separate doctrine.¹⁴⁰ First and foremost, the divergence is the product of the business judgment rule. The business judgment rule is one of the most fundamental principles of corporate law.¹⁴¹

139. Under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985), directors are subject to an intermediate standard of review, as a threshold inquiry, if they engage in takeover defense. Setting aside the question of whether the standard of review is demanding, it could be avoided altogether by avoiding takeover defenses. This would leave matters in shareholders' hands when the acquirer inevitably conducts a tender offer.

140. Although the two types of standards are dealt with in separate sections under the Model Business Corporation Act, see §§ 8.30-.31 (2005), neither is explicitly addressed in the Delaware General Corporation Law. See *supra* notes 83-84 and accompanying text.

141. See *Aronson v. Lewis*, 473 A.2d 805, 811-12 (Del. 1984) (“A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders,

According to the Delaware courts, “It 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.”¹⁴² This “powerful presumption”¹⁴³ shields directors’ decisions from review in all but the most extreme cases.¹⁴⁴ In duty of care cases, evidence of negligence is insufficient to rebut the presumption; plaintiffs must establish gross negligence.¹⁴⁵ In duty of loyalty cases, evidence of a conflict of interest is insufficient; plaintiffs must establish a financial or familial conflict that rises to the level of self-dealing.¹⁴⁶ In duty of good faith cases, evidence of lack of good faith is insufficient; plaintiffs must establish intentional misconduct.¹⁴⁷ The business judgment rule is most powerful in cases challenging the substance of business decisions. In such cases, evidence of a very bad decision is insufficient; plaintiffs must establish that the decision was utterly irrational and amounted to waste.¹⁴⁸ Protection of the business judgment rule is what gives rise to the divergence between standards of conduct and standards of review.

The judicial defense of the business judgment rule begins with the language of the corporation statutes,¹⁴⁹ which provide that “[t]he business and affairs of every corporation ... shall be managed by or

manage the business and affairs of the corporation.... The business judgment rule is an acknowledgement of the managerial prerogatives of Delaware directors under Section 141(a).”), *overruled on other grounds* by *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

142. *Id.* at 812.

143. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

144. *See id.*

145. *Aronson*, 473 A.2d at 812.

146. *Cede & Co.*, 634 A.2d at 363 (citing *Aronson*, 473 A.2d at 812).

147. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 66-67 (Del. 2006), *aff’g* 907 A.2d 693 (Del. Ch. 2005).

148. *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (“Irrationality is the outer limit of the business judgment rule.” (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971))). A fifth category of cases involves structural bias. In such cases, it is insufficient to present evidence of bias; plaintiffs must show that the decision was unreasonable under the circumstances. *See generally* Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1244-48 (2010).

149. *See Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (“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.”), *overruled on other grounds* by *Gantler v. Stephens*, 965 A.2d 695, 713 n.54 (Del. 2009).

under the direction of a board of directors,”¹⁵⁰ rather than by the shareholders who would challenge their decisions or the courts that would evaluate them.¹⁵¹ It is often noted that business decisions are inherently risky and should not be subject to second-guessing after the fact.¹⁵² Courts in particular are said to be ill equipped to make or review business decisions.¹⁵³ Shareholders, on the other hand, can be said to have assumed the risk by investing in equity securities.¹⁵⁴

150. DEL. CODE ANN. tit. 8, § 141(a) (2011).

151. See *Van Gorkom*, 488 A.2d at 872 (“The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors.”); see also *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979) (“[B]y definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility.”).

152. See *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982). The *Joy* court stated,

[C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decisions, inevitably based on less than perfect information. The entrepreneur’s function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge.

Id. See generally Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 619-23 (1998).

153. See *Rosenfield v. Metals Selling Corp.*, 643 A.2d 1253, 1262 (Conn. 1994) (“Courts recognize that managers have both better information and better incentives than they.... ‘Not only do businessmen know more about business than judges do, but competition ... provides sufficient punishment for businessmen who commit more than their share of business mistakes.’” (quoting *Dynamics Corp. of Am. v. CTS Corp.*, 794 F.2d 250, 256 (7th Cir. 1986))); *Brehm*, 746 A.2d at 263 (“Courts are ill-fitted to attempt to weigh the ‘adequacy’ of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk.” (quoting *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997))); *Daniels v. Thomas, Dean & Hoskins, Inc.*, 804 P.2d 359, 367 (Mont. 1990) (“Judges are not business experts and therefore should not substitute their judgment for the judgment of the directors.”); *Auerbach*, 393 N.E.2d at 1000 (“[T]he business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments.”); *Cuker v. Mikalauskas*, 692 A.2d 1042, 1046 (Pa. 1997) (“[The business judgment] doctrine prevents courts from becoming enmeshed in complex corporate decision-making, a task they are ill-equipped to perform.”).

154. See *Joy*, 692 F.2d at 885 (“[S]hareholders to a very real degree voluntarily undertake the risk of bad business judgment. Investors need not buy stock, for investment markets offer an array of opportunities less vulnerable to mistakes in judgment by corporate officers.”); *Gagliardi v. TriFoods Int’l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996) (“Shareholders don’t want (or shouldn’t rationally want) directors to be risk averse. Shareholders’ investment interests ... will be maximized if corporate directors and managers honestly assess risk and reward and accept for the corporation the highest risk adjusted returns available that are above the firm’s cost of capital.”).

Therefore, they should not complain when things do not turn out as hoped.¹⁵⁵

Legal enforcement of fiduciary duties exposes directors to the risk of liability. This can discourage people from serving on boards because the potential liability would far exceed the compensation received.¹⁵⁶ Exculpation statutes, which helped eliminate liability for breach of the duty of care, were adopted for this very reason.¹⁵⁷ Perhaps even more important, however, is the effect that excessive liability would have on directors' business judgment. Because risk and return are related, shareholders want directors to take appropriate business risks. However, if directors face potential liability when things go wrong, they might well become excessively risk averse.¹⁵⁸ This would have the effect of reducing the rate of return

155. See *Joy*, 692 F.2d at 885 (“Since shareholders can and do select among investments partly on the basis of management, the business judgment rule merely recognizes a certain voluntariness in undertaking the risk of bad business decisions.”); *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996) (“If the shareholders thought themselves entitled to some other quality of judgment than such a director produces in the good faith exercise of the powers of office, then the shareholders should have elected other directors.”).

156. See *Air Line Pilots Ass’n, Int’l v. UAL Corp.*, 717 F. Supp. 575, 582 (N.D. Ill. 1989) (“It would be considerably more difficult to recruit directors to serve on corporate boards if their business decisions were subject to substantive scrutiny. The business judgment rule encourages competent individuals to become directors who otherwise might decline for fear of personal liability.” (citation omitted)), *aff’d*, 897 F.2d 1394 (7th Cir. 1990); Eisenberg, *supra* note 1, at 445; Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 312-13 (1994).

157. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2011). See generally John L. Reed & Matt Neiderman, “Good Faith” and the Ability of Directors to Assert § 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty, 29 DEL. J. CORP. L. 111, 113-19 (2004); Leo E. Strine, Jr. et al., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 659-63 (2010).

158. See *Joy*, 692 F.2d at 886 (“[B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions.”); *Caremark*, 698 A.2d at 967 n.16 (“If those in charge of the corporation are to be adjudged personally liable for losses ... based upon what ... persons of ordinary or average judgment ... regard as ‘prudent[,]’ ‘sensible[,]’ or even ‘rational[,]’ such persons will have a strong incentive at the margin to authorize less risky investment projects.”); *Gagliardi*, 683 A.2d at 1052 (“[D]irectors will tend to deviate from this rational acceptance of corporate risk if in authorizing the corporation to undertake a risky investment, the directors must assume some degree of personal risk relating to *ex post facto* claims of derivative liability for any resulting corporate loss.”); Eisenberg, *supra* note 1, at 444-46; Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors’ Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 450 (2005); Gevurtz, *supra* note 156, at 306.

that shareholders could expect on their investments.¹⁵⁹ Thus, it is in the interests of both directors and shareholders to reduce the directors' exposure to liability.

One important way to do this is to lower the standards of review.¹⁶⁰ Low standards of review give the directors room to make honest mistakes. With liability reserved for the worst offenders, directors are free to concentrate on business matters.¹⁶¹ They can rest assured that, even if they happen to fall short of the standard of conduct, they likely would remain in compliance with the corresponding standard of review—and free from liability.¹⁶² The divergence is a powerful tool that allows directors to pursue the interests of the corporation and its shareholders aggressively.

The business judgment rule can be characterized as allowing room for error on the part of honest directors, but it can also be characterized as allowing room for error on the part of the courts, or at least compensating therefor.¹⁶³ If the legal system were perfect, honest directors would not have to fear liability. Only directors who were actually negligent or irrational, or engaged in unfair self-dealing or intentional misconduct, would face liability. Such directors *should* be held liable. Because litigation is imperfect, however, an honest and faithful director might erroneously be considered negligent or irrational, or to have engaged in unfair self-dealing or intentional misconduct. The divergence between standards of conduct and standards of review can help. Corporate law recognizes that if fiduciary duties were enforced at the level of standards of conduct, then imperfect litigation likely would lead to overenforcement of fiduciary duties.¹⁶⁴ This would stifle entrepreneurialism and wealth generation. Underenforcement of fiduciary duties by means of lowered standards of review solves this problem. Moreover, com-

159. See Fairfax, *supra* note 158, at 450.

160. See *id.*

161. See *supra* note 5 and accompanying text.

162. See Allen et al., *supra* note 99, at 455; Eisenberg, *supra* note 1, at 464 (“[F]rom the perspective of an actor proposing to engage in certain conduct, standards of conduct are ‘safe’ rules and standards of review are ‘risky’ rules.”).

163. See Eisenberg, *supra* note 1, at 464.

164. See, e.g., Allen et al., *supra* note 99, at 452 (“[E]ven the best of us will occasionally make a lapse in judgment or a factual error that a judge could later second-guess as ‘unreasonable’ or ‘negligent.’”); Eisenberg, *supra* note 1, at 444 (“Under a reasonableness standard of review, ... factfinders might too often erroneously treat decisions that turned out badly as bad decisions, and unfairly hold directors liable for such decisions.”).

pensating for the limits of litigation does not simply trade overenforcement for underenforcement. Because imperfect litigation likely would lead to overenforcement of the standard of review, the result may not be so far from the appropriate level of enforcement for the standard of conduct.

Assuring directors that they will only be found to have breached the duty of care if they are *grossly* negligent provides great comfort. Of course, mistakes are still possible: directors may wrongly be found to have acted with gross negligence. That is likely only when directors were actually negligent, however. It seems highly unlikely that a director who acted with due care will be found to have been grossly negligent.¹⁶⁵ Directors can feel confident that, as long as they try to act with due care, they will not be found liable for breach of the duty of care. The same can be said with respect to the other fiduciary duties as well. With respect to the duty of loyalty, a court might wrongly conclude that a director acted unfairly, but only when there was a conflict of interest. Directors can be confident that, as long as they avoid conflicts of interest, they will not be held liable for a breach of the duty of loyalty. With respect to the duty of good faith, a court might wrongly conclude that a director engaged in intentional misconduct. However, this seems extremely unlikely if directors try to conduct themselves above reproach; it seems to be a risk only when directors decide to engage in questionable dealings. And, of course, courts might wrongly conclude that a decision was irrational and amounted to waste. However, the rarity of such holdings suggests that there is *very* little to fear on this front.¹⁶⁶ A decision would have to be quite bad indeed to be considered irrational.¹⁶⁷

165. *But see* Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985), *overruled on other grounds* by Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

166. “That is ‘an extreme test, very rarely satisfied by a shareholder plaintiff.’” Zupnick v. Goizueta, 698 A.2d 384, 387 (Del. Ch. 1997) (quoting Steiner v. Meyerson, No. 13139, 1995 Del. Ch. LEXIS 95, at *3 (Del. Ch. July 19, 1995)). According to Chancellor Allen in *Gagliardi v. TriFoods International, Inc.*, 683 A.2d 1049, 1051-52 (Del. Ch. 1996), “There is a theoretical exception ... that holds that some decisions may be so ‘egregious’ that liability for losses they cause may follow The exception, however, has resulted in no awards of money judgments against corporate officers or directors in this jurisdiction.” *But see* Fidanque v. Am. Maracaibo Co., 92 A.2d 311, 321 (Del. Ch. 1952) (“Since the payment ... constitutes an illegal gift of corporate funds and amounts to waste, ... it is therefore null and void.”).

167. To prove waste, the shareholders bear the burden of establishing that “[the consideration] the corporation has received is so inadequate in value that no person of

This, then, is the fundamental justification for the business judgment rule generally, and for the divergence between standards of conduct and standards of review specifically: they protect directors from honest mistakes on their part as well as from inevitable mistakes on the part of the legal system. This empowers directors to pursue the interests of the corporation and its shareholders to the best of their abilities, without excessive fear of liability.

At the heart of the room-for-error theory is a cost-benefit analysis. Society must weigh the competing values of directorial authority and accountability.¹⁶⁸ In this analysis, the limits of litigation loom large. Society has concluded that the costs of enforcement often outweigh the benefits. As Eisenberg put it,

If directors or officers who violate the standards of reasonableness and fairness sometimes escape liability because of a less demanding standard of review, it is not because they have acted properly, but because utilizing standards of review that were fully congruent with the relevant standards of conduct would impose greater costs than the costs of letting some persons who violated their standards of conduct escape liability.¹⁶⁹

However, the cost-benefit analysis could change over time as different factors shift. If litigation became less imperfect, or if directors became more malfeasant, the current balance achieved by the business judgment rule may become obsolete. The enforcement of standards of conduct could be appropriate in the future.

The room-for-error theory is more compatible with the mandatory view than the aspirational view. Although the views are all con-

ordinary, sound business judgment would deem it worth that which the corporation has paid." *Grobow v. Perot*, 539 A.2d 180, 189 (Del. 1988) (quoting *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962)), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 253 & n.13 (Del. 2000); *see also* *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) ("Roughly, a waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."); *Glazer v. Zapata Corp.*, 658 A.2d 176, 183 (Del. Ch. 1993) ("[T]he legal test [for waste] is severe. Directors are guilty of corporate waste, only when they authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.").

168. *See* E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 *BUS. LAW.* 393, 403 (1997) ("The defining tension in corporate governance today is the tension between deference to directors' decisions and the scope of judicial review.").

169. Eisenberg, *supra* note 1, at 467-68.

sistent in terms of the end result—reduced enforcement of fiduciary duties—they do not share a common philosophy. Under the aspirational view, standards of conduct are inherently aspirational and ought not to be enforced. By contrast, the mandatory view would prefer to enforce standards of conduct and only reluctantly yields on the issue because of competing values. The room-for-error theory provides for reduced enforcement because of a cost-benefit analysis. This seems more compatible with the mandatory view than the aspirational view. But for the associated costs, standards of conduct would be enforced.

III. BIFURCATION OR TRIPARTITION?

Without giving it much thought, most people probably assume that the law of fiduciary duties is bifurcated. On the one hand, there are standards of conduct; on the other hand, standards of review. It might seem difficult to imagine how fiduciary duties could be described otherwise, but there is an alternative schema which is superior as a descriptive matter.

A bifurcated view of fiduciary duties is not inherently problematic. It highlights an important distinction in the law. However, it fails to capture some important nuances. The major shortcoming of bifurcation is that it suggests that the divide is starker than it needs to be, which can easily lead to an extreme version of bifurcation that is unwarranted. Although there are only two types of standards in the law of fiduciary duties, they need not be characterized as polar opposites. Each standard need not be simply what the other is not; the two types of standards share many characteristics and are more similar than different.

In this Part, I will challenge the assumption that bifurcation is the best way to describe the law of fiduciary duties. First, I will demonstrate that the aspirational view succumbs to the temptation of extreme bifurcation. In other words, it not only recognizes a divergence between standards of conduct and standards of review, but also describes that divergence in radical terms. Then I will argue that the divergence actually creates a tripartite division in the law of fiduciary duties. By establishing two separate thresholds, the law divides the universe of fiduciary duties into three zones. This tripartition framework is superior to bifurcation because it provides additional flexibility and allows for greater nuance.

A. Bifurcation

To bifurcate means “to divide into two parts or branches.”¹⁷⁰ In one sense, then, it is perfectly fair to say that fiduciary duties are bifurcated into standards of conduct and standards of review. However, “mere” bifurcation does not say very much about either branch. Any set can be bifurcated, regardless of whether it consists of similar or disparate items. Thus, to say that fiduciary duties are bifurcated does not tell us how great the divergence is. Only through “extreme” bifurcation are the items of a set distinguished significantly.

By definition, the aspirational view exhibits extreme bifurcation of fiduciary duties. It not only recognizes the divergence, but also describes the divergence in radical terms. This is evidenced in the language its proponents use when discussing standards of conduct and standards of review. For example, a failure to comply with a standard of review is accurately considered to be a *breach* of fiduciary duty. However, proponents of the aspirational view claim that a failure to comply with a standard of conduct, although not ideal, is not a breach.¹⁷¹ This is not an inescapable conclusion. Under the mandatory view, a failure to comply with the standard of conduct also could be considered a breach of fiduciary duty. Unless there is also a failure to comply with the standard of review, however, the plaintiffs cannot establish a breach that would invoke judicial intervention. Similarly, standards of review are accurately considered to be *enforceable*. And yet proponents of the aspirational view claim that standards of conduct are *unenforceable*.¹⁷² The term “unenforceable,” although somewhat ambiguous,¹⁷³ is highly sugges-

170. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE, *supra* note 6, at 178.

171. Throughout its final opinion in the *Disney* case, the Delaware Supreme Court acknowledged Eisner’s shortcomings, yet insisted that he had not breached his fiduciary duties. See *supra* notes 77-81 and accompanying text.

172. Rock & Wachter, *supra* note 21, at 1622 (“[T]he *raison d’être* of firms is to replace legal governance of relations with nonlegally enforceable governance mechanisms.”).

173. The term “unenforceable” means “unable to be enforced.” However, this inability could be a contextual inability, limited to specific circumstances, such as current law, or an absolute inability, based on the nature of things. In this context, therefore, unenforceable could mean not subject to enforcement under current law, but it could also mean intrinsically incapable of being enforced. Even if an author intends the former meaning, it could easily be interpreted to mean the latter. Most likely, the issue is never given much thought, allowing the suggestion of the latter meaning to linger.

tive of an impossibility of enforcement—or at least of the inappropriateness thereof. Under the mandatory view, standards of review are simply unenforced, but potentially enforceable. Finally, standards of review are accurately considered to be mandatory. However, proponents of the aspirational view claim that standards of conduct are aspirational.¹⁷⁴ Again, the term “aspirational” is highly suggestive of optionality, and possibly even unachievability.¹⁷⁵ Under the mandatory view, standards of conduct remain mandatory and binding upon actors, even if they are unenforced. In short, the aspirational view sets up a divide that is quite extreme. By maximizing the significance of the divergence between the two types of standards, the aspirational view minimizes the significance of the standards of conduct.

Proponents of the aspirational view often go beyond the extreme bifurcation that is inherent in the aspirational view itself. If the law of fiduciary duties is bifurcated, then one would expect both standards of review and standards of conduct to be considered law, and distinct from that which is not law. However, proponents of the aspirational view often distinguish standards of review from everything else, lumping standards of conduct together with nonlegal forces. Sometimes, they even go so far as to suggest that standards of conduct are not law at all.

The most pronounced example can be found in the work of Professors Rock and Wachter.¹⁷⁶ Indeed, their entire focus is on the distinction between that which is legally enforceable—that is, standards of review—and what they call NLERS, or “nonlegally enforceable rules and standards.”¹⁷⁷ Rock and Wachter’s concept of NLERS extends beyond fiduciary duty standards of conduct precisely because the relevant issue for them is legal enforcement. In other words, the difference between “legal and nonlegal enforceability” is the difference between “law’ and ‘norms.’”¹⁷⁸ Thus,

174. *See supra* Part I.

175. *See supra* notes 6-9 and accompanying text.

176. *See supra* notes 21-25 and accompanying text.

177. Rock & Wachter, *supra* note 21, at 1623.

178. Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law*, 149 U. PA. L. REV. 1607, 1611 (2001). At one point, the authors state their view that “NLERS are ... understood to impose obligations, but without legal enforcement.” Rock & Wachter, *supra* note 21, at 1641. However, they are not using the term “obligation” in the same sense as the mandatory view. What they mean is any type of moral or social obligation in the sense of “rules and standards” as opposed to “mere behavioral regularities.” *Id.* They do not mean to suggest a

standards of conduct are relegated to the same status as any other norms or NLERS.

Another pronounced example of this extreme bifurcation can be found in the work of Professors Hill and McDonnell.¹⁷⁹ Not unlike Rock and Wachter, their main distinction is between “law on the books and as enforced”¹⁸⁰ and “extra-legal forces ... that extend[] Delaware corporate law significantly.”¹⁸¹ The former category, which includes standards of review, is described as “[l]aw, in its traditional sense.”¹⁸² The latter category, which they call the “penumbra,” essentially relegates standards of conduct to dictum and then lumps them together with all other “voices ... in the corporate governance debate.”¹⁸³ Although their goal is not to undermine fiduciary duties, but rather to extend the reach of corporate law, they clearly view standards of conduct as having more in common with nonlegal influences than with standards of review.

This extreme bifurcation is also evident in the legal opinions for the *Disney* case. For example, the Delaware Supreme Court distinguished between “the law of corporate fiduciary duties and remedies for violation of those duties” on the one hand and “the aspirational goals of ideal corporate governance practices” on the other.¹⁸⁴ It described the former as “minimal legal requirements” and the latter as “highly desirable” but “not required.”¹⁸⁵ The court did not even bother to distinguish fiduciary duty standards of conduct from other aspirational goals, and it is not at all clear that it perceived any such distinction. In a later opinion, the Delaware Supreme Court similarly distinguished between “best practices” on the one hand and “the level required for a proper exercise of due care” on the other hand.¹⁸⁶ Likewise, the court of chancery distinguished between “ideals of corporate governance” on the one hand and “a fiduciary’s duties” on the other.¹⁸⁷ The former are “aspirational,” “worthy as

legal obligation.

179. *See supra* notes 26-36 and accompanying text.

180. *See* Hill & McDonnell, *supra* note 26, at 335.

181. *Id.*

182. *Id.* at 352.

183. *Id.* at 336.

184. *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000).

185. *Id.*

186. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 56 (Del. 2006), *aff’d* 907 A.2d 693 (Del. Ch. 2005).

187. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697 (Del. Ch. 2005), *aff’d*, 906

goals for human behavior,” and “strongly encourage[d]” by the courts,¹⁸⁸ but “should not work to distort the legal requirements.”¹⁸⁹ The latter are “legal requirements by which human behavior is actually measured”¹⁹⁰ and “do not change over time.”¹⁹¹ Again, the court never clearly indicated whether there is a distinction between fiduciary duty standards of conduct and aspirational ideals of corporate governance. Given that the language of the divergence is well known in corporate law, this omission strongly suggests that any difference is, at best, irrelevant.

In his extrajudicial writings, Veasey also distinguishes between “the law of corporate fiduciary duties and remedies for violation of those duties” on the one hand and “the aspirational goals of ideal corporate governance practices” on the other.¹⁹² Those “aspirational goals” are standards of conduct,¹⁹³ and they do not seem to comprise “the law of corporate fiduciary duties.”¹⁹⁴ They are only what a director *should* do.¹⁹⁵ Again, it does not seem to be relevant for Veasey to distinguish standards of conduct that are considered fiduciary duties from those that are not.

In fairness, this extreme bifurcation is often implicit rather than explicit, and in some cases may not have been intended by the author. Nevertheless, it is important to draw this out. My concern is not so much about what particular scholars or judges believe; rather, it is about how what they say can influence the development of the law. My point is that the aspirational view tends to exhibit an extreme form of bifurcation that maximizes the divide between standards of conduct and standards of review. As I will show in the

A.2d 27.

188. *Id.* at 697-98.

189. *Id.* at 698.

190. *Id.*

191. *Id.* at 697.

192. Veasey, *supra* note 83, at 2188-89.

193. *See supra* notes 86-88 and accompanying text.

194. At times, Veasey seems to say that standards of conduct are not fiduciary duties at all. For example, one of the headings for a section in which he discusses the divergence is labeled, “Fiduciary Duties, Not Aspirational Standards of Conduct, Establish Standards of Liability.” Veasey, *supra* note 85, at 536.

195. In fairness, Veasey would say that standards of conduct can sometimes lead to liability and therefore are not always “merely” aspirational. However, this is true only when standards of conduct overlap standards of review. For Veasey, when the two do not overlap, standards of conduct are aspirational. *See supra* notes 87-89 and accompanying text.

next Section, this is not the only way to interpret the divergence, nor is it the best way.

B. Tripartition

Although it may seem obvious to assume that the divergence between standards of conduct and standards of review leads to bifurcation, this is not the best interpretation. As a schema, bifurcation assumes that the divergence creates two zones: one for the standard of conduct and another for the standard of review. However, these two standards should not be viewed as zones.¹⁹⁶ Rather, they should be understood as thresholds.¹⁹⁷ If there are two

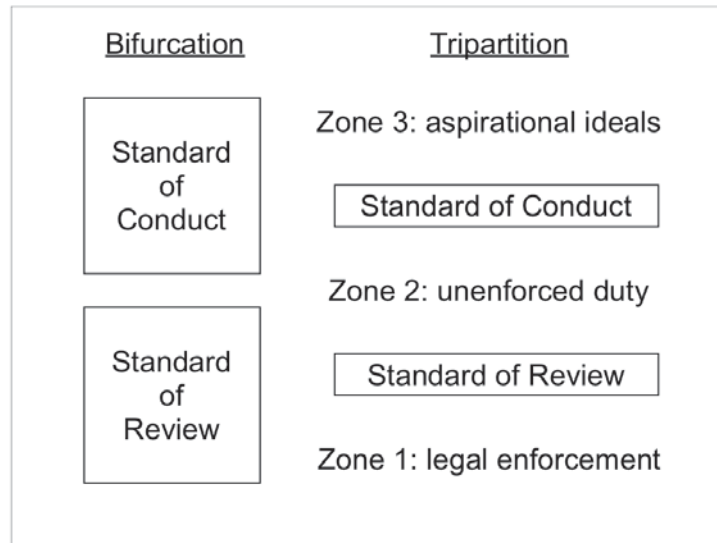
196. If each standard is imagined as a zone, as shown in Diagram 1, then things get rather complicated. Although one might think that each zone labeled represents compliance with the titular standard, it actually represents *lack of compliance*. For example, if the “standard of review” zone represents the zone of legal enforcement, then it must comprise conduct that fails to satisfy the standard of review. (Conduct that barely satisfies the standard of review actually fails to satisfy the standard of conduct.) Logically, therefore, the “standard of conduct” zone should represent lack of compliance with the standard of conduct. This leads to the realization that a third zone is necessary in order to represent compliance with the standard of conduct—that is, aspirational ideals. *See infra* notes 199, 201 and accompanying text. (Alternatively, if each zone is determined to represent compliance with its titular standards, there is still a need for a third zone to represent lack of compliance with the standard of review, which can lead to legal enforcement.) In order to insist upon bifurcation, the standard of conduct zone must represent compliance with the standard of review without reference to the standard of conduct. In other words, it must represent both standards of conduct and aspirational ideals.

197. The suggestion that standards should be imagined as thresholds rather than zones is hardly novel. In ordinary discourse, we generally refer to standards as creating thresholds for behavior. For example, we say that one must exercise a certain amount of care to avoid negligence, and another amount of care to avoid gross negligence. *See, e.g.*, *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). In terms of fairness, we say there must be a certain amount, or type, of process to achieve fair dealing, and a certain level of substance to achieve fair price. *See, e.g.*, *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983). In terms of good faith, misconduct becomes actionable when it is intentional. *See, e.g.*, *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 62-68 (Del. 2006), *aff’d* 907 A.2d 693 (Del. Ch. 2005). And the demanding nature of the waste test means that the threshold for substance is set very low. *See id.* at 74.

One might argue that fairness is sometimes characterized as a zone, as when people speak of a “range of fairness.” *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 869, 877 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695, 713 n.54 (Del. 2009); *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 619, 622 (Del. Ch. 2005); *see also Eisenberg, supra* note 1, at 450 (“In many contracts fairness is a range, rather than a point.”). However, this is merely a colloquialism that suggests that the threshold cannot be determined easily or mechanically and requires flexibility and judgment. In fact, fairness remains a threshold, albeit a fuzzy or uncertain one. That it is not truly a “range” is evidenced by the

thresholds, then there are *three* zones. For this reason, it is more appropriate to speak of the tripartition of the law of fiduciary duties rather than its bifurcation. The diagram below illustrates my argument.

DIAGRAM 1



The first zone represents a failure to satisfy—that is, a failure to meet the threshold for—the standard of review. This is the zone of legal enforcement of fiduciary duties. In *Disney's* terms, it is the realm of “personal liability” and “remedies for violation.”¹⁹⁸ Here, a plaintiff should be able to establish a breach of fiduciary duty, making labels such as “mandatory” and “enforceable” uncontroversial.

The second zone represents compliance with the standard of review, but failure to satisfy the standard of conduct. Bifurcation overlooks this, or at least fails to do it justice. Because standards of conduct are as much a part of the law of fiduciary duties as are standards of review, this zone is equally mandatory. Failure to satisfy the standard of conduct should be considered a breach. Legal

fact that there is no upper limit: surely a court would not find unfairness because of excessive process or generous price!

198. *Brehm*, 746 A.2d at 255-56.

enforcement is not an option, however: a breach of fiduciary duty cannot be established for purposes of litigation because the conduct in question satisfies the standard of review. Thus, this is the zone of the “unenforced duty.”

The third zone represents compliance with—that is, exceeding the threshold for—both standards of review and standards of conduct. Because all fiduciary duties have been satisfied, there is no breach. Conduct in this zone may be praiseworthy,¹⁹⁹ but it is never mandatory. This is the zone of aspirational ideals. Standards of conduct that are part of a fiduciary’s duties do not belong here.

In order to illustrate the three zones more fully, I will use the duty of care as an example. The first threshold, the standard of review, is gross negligence. The second threshold, the standard of conduct, is negligence.²⁰⁰ The first zone, legal enforcement, represents a failure to satisfy the standard of review. Conduct in this zone is grossly negligent. The second zone, unenforced duty, represents a satisfaction of the standard of review but not of the standard of conduct. Conduct in this zone is negligent. The third zone, aspirational ideals, represents satisfaction of the standard of conduct. Conduct in this zone might be described as careful.²⁰¹

The difference between bifurcation and tripartition is clear. There is no difference between the two views in how they handle standards of review. The difference lies in how they handle standards of conduct and aspirational ideals. Whereas tripartition deals with them separately, bifurcation seems to lump them together. Thus, tripartition is a more robust framework. It offers more flexibility and allows for greater nuance.

To be fair, it is not bifurcation that is the problem, but extreme bifurcation. Technically speaking, fiduciary duties *are* bifurcated into standards of conduct and standards of review. However, this bifurcation describes only law, and not that which is not law. In other words, bifurcation cannot explain aspirational ideals. As long

199. Not all conduct that exceeds the requirements of law is praiseworthy. It is possible to be excessive. For example, too much care may stifle appropriate entrepreneurial risk. This would unduly compromise success and profitability and would not be considered desirable. For purposes of this Article, I will ignore conduct that is excessive in this sense. Although I do not mean to suggest that the risk is insignificant, it is not relevant to the current discussion.

200. *See supra* notes 2, 145 and accompanying text.

201. Of course, this zone also includes conduct that may be described as excessively careful and therefore suboptimal. *See supra* note 199.

as this limitation is recognized, there should be no problem with bifurcation. The problem arises when one tries to blur the distinction between standards of conduct and aspirational ideals.

The aspirational view wrongly assumes that bifurcation explains everything. As a result, it sees only the two extremes—mandatory duties and aspirational ideals. It then assumes that these two extremes correspond to the two types of standards—standards of review and standards of conduct, respectively. In doing so, it fails to account for the unenforced duty and simply collapses the concept into aspirational ideals.

Tripartition, on the other hand, can easily accommodate both unenforced duties and aspirational ideals. Although aspirational ideals are not themselves fiduciary duties, they are an important part of the fiduciary duty landscape. The ability to accommodate the distinction between standards of conduct and aspirational ideals is an advantage that tripartition has over bifurcation. It allows for the preservation of nuance that bifurcation has difficulty capturing. The only way for bifurcation to deal with aspirational ideals is either to acknowledge that it cannot encompass them or to insist that they are indistinguishable from standards of conduct. The first approach is not particularly helpful; the second is actually harmful.

Bifurcation suggests a false dichotomy: that standards of review are law and that standards of conduct are not.²⁰² The law of fiduciary duties is significantly more nuanced. The ability to deal with a third category that is not actually law is what makes tripartition better at understanding the law as a practical matter. The inability to do so leads bifurcation to error.

IV. STANDARDS OF CONDUCT ARE NOT MERELY ASPIRATIONAL

In Part III, I argued that tripartition is a better framework for understanding the law of fiduciary duties than is the more common view of bifurcation. Tripartition is superior because it provides more flexibility and allows for greater nuance, especially in distinguishing between unenforced duties and aspirational ideals. In this Part, I will defend tripartition and the mandatory view more fully. First, I will argue that standards of conduct are not inherently aspirational. Far from being unachievable, they are entirely mundane and per-

202. See *Brehm*, 746 A.2d at 256.

fectly capable of being enforced. Next, I will argue that the concept of unenforced duties is a meaningful one and distinct from aspirational ideals. This is because people obey the law for many different reasons, and not simply out of fear of punishment. Finally, I will argue that standards of conduct are not necessarily *unenforced* duties, as I have assumed thus far, but possibly *underenforced* duties. If this is true, it blurs the distinction between standards of conduct and standards of review. The two types of standards are different in degree rather than kind.

A. Are Standards of Conduct Aspirational?

In this Section, I argue that fiduciary duty standards of conduct are not inherently aspirational. Far from being unachievable, they are entirely mundane and capable of being enforced. First, I will demonstrate that, although the courts sometimes use lofty language to describe fiduciary duties, the leading cases do not suggest the contrary. Then I will show that common formulations of fiduciary standards of conduct are not very lofty at all.

Most of the lofty language upon which courts and scholars rely stems from a handful of frequently-cited opinions that have been very influential. The two most important opinions are from the cases of *Meinhard v. Salmon*²⁰³ and *Guth v. Loft, Inc.*²⁰⁴ A brief examination will demonstrate that such opinions are not nearly as problematic as they are made to seem.

Consider, first, the case of *Meinhard*. In that case, there were two coadventurers, treated essentially as partners, who had leased and were operating a hotel.²⁰⁵ Meinhard was an investor only, whereas Salmon was also the manager. As the term of the lease—and the partnership—came to an end, Salmon negotiated for himself alone an extension and expansion of the lease. When Meinhard learned of this, he demanded to be included and sued Salmon for breach of the duty of loyalty. The New York Court of Appeals viewed the case as involving a “corporate opportunity,” and Meinhard prevailed.²⁰⁶

203. 164 N.E. 545 (N.Y. 1928).

204. 5 A.2d 503 (Del. 1939).

205. *Meinhard*, 164 N.E. at 545-46.

206. *Id.* at 546-49.

More interesting than either the facts or the holding of the case is the language that the court used when discussing fiduciary duties. The following passage in particular is of perennial interest:

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.²⁰⁷

This is one of the most celebrated passages of its kind. It discusses fiduciary duties in very lofty and grandiose terms. The modern reader easily might interpret this passage more broadly than likely was intended. Taken in context, however, it is not saying nearly as much as might be supposed.

Clearly the passage contains some very lofty language. The court spoke of "the duty of the finest loyalty" and "[n]ot honesty alone, but the punctilio of an honor the most sensitive."²⁰⁸ However, seemingly hidden in the passage are various statements that are surprisingly mundane. For example, the court said that "[a] trustee is held to something stricter than the morals of the market place" and that "the level of conduct for fiduciaries [has] been kept at a level higher than that trodden by the crowd."²⁰⁹ Given that at common law, the "morals of the market place" amounted to little more than a prohibition against fraud,²¹⁰ the higher standard to which fiduciaries

207. *Id.* at 546 (citation omitted).

208. *Id.*

209. *Id.*

210. See, e.g., *In re Auto Specialties Mfg. Co.*, 153 B.R. 457, 488-89 (Bankr. W.D. Mich. 1993) (discussing phrase "morals of the marketplace" as prohibiting only "egregious conduct," "fraud," and "conduct [that] shock[s] the conscience"); *In re Sleepy Valley, Inc.*, 93 B.R. 925, 933 (Bankr. W.D. Tex. 1988); John Bourdeau et al., 17A C.J.S. *Contracts* § 205 (2012); Timothy A. French, *The Rise and Fall of the Doctrine of Equitable Subordination as Applied*

are held is not necessarily very high at all. Rather than taking particular statements out of context, we should read them all together, consistently if possible. This is not as difficult as it seems.

When interpreting the loftier statements, we need to consider the intended baseline. If one supposes that the baseline was the faithful fiduciary, then the lofty language would seem to be pushing fiduciary duties to ever-greater heights. However, if the baseline is only market participants, then these passages are doing little more than saying that fiduciaries are held to a higher standard. The former interpretation, which is admittedly quite common, leaves the passage with something of a schizophrenic feel. The latter interpretation harmonizes the various statements, which suggests that it is the appropriate one.

The court used similar lofty language at various points throughout the opinion. Among the more powerful passages are the following: “Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish”;²¹¹ “Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation”;²¹² “For [Salmon] and for those like him the rule of undivided loyalty is relentless and supreme.”²¹³ Once again, it is easy for the reader to misinterpret these passages. It would be wrong, however, to give these statements a maximum interpretation. Surely the court did not mean to say quite so much. After all, the loyalty of partners is never truly “undivided and unselfish.” Partners are to seek their mutual benefit, rather than the exclusive benefit of the others. It is not the case that “thought of self was to be renounced.” What these passages are trying to say, in admittedly grandiose terms, is that partners cannot ignore each other’s interests and must treat each other fairly, perhaps even beyond reproach. Otherwise, the court’s suggestion that Salmon may have been able to satisfy his fiduciary duties to Meinhard merely by disclosing the opportunity

to *Nonmanagement Creditors*, 4 J. BANKR. L. & PRAC. 257, 288 (1995) (implying that the “morals of the marketplace” permit conduct other than fraud or breach of contract).

211. *Meinhard*, 164 N.E. at 548.

212. *Id.*

213. *Id.*

to him and giving him the opportunity to compete for it²¹⁴ is difficult to reconcile.

In the end, the case is a fairly typical corporate opportunity case. One partner took an opportunity that the court believed belonged to the partnership, and this was found to be a breach of the duty of loyalty.²¹⁵ What is noteworthy about the case is not so much the lofty dictum, which is easily exaggerated, but the remedy. Despite the termination of the partnership by its own terms, Salmon was forced to share a much larger opportunity and for a much longer duration than ever anticipated.²¹⁶ Although this might strike some as excessive, it is a problem of remedies, not a problem with the standard of conduct or the standard of review.

The *Guth* case is actually very similar. In that case, Guth was a shareholder and officer of Loft.²¹⁷ He was accused of using the company to develop a side business which he then took for himself.²¹⁸ The court found Guth to have breached his duty of loyalty and required him to transfer the business opportunity to Loft.²¹⁹

The most celebrated passage from the opinion is the following:

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it,

214. On this issue, the court is noncommittal: "He might have warned Meinhard ... that either would be free to compete for the award. If he had done this, we do not need to say whether he would have been under a duty, if successful in the competition, to hold the lease so acquired for the benefit of a venture then about to end." *Id.* at 547. However, this reticence is understandable. After all, Salmon might have had an unfair advantage in the opportunity arising from his position in the partnership.

215. *Id.* at 549.

216. *See id.* at 548-49.

217. *Guth v. Loft, Inc.*, 5 A.2d 503, 504-05 (Del. 1939).

218. *Id.* at 506.

219. *Id.* at 515.

or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.²²⁰

Again, the court used some language that seems very lofty. If the language in this passage is given the strongest interpretation that the words will bear, then fiduciary duties would rightly be considered not only aspirational and unenforceable, but perhaps even unachievable. After all, it would be humanly impossible for each director and officer always “to refrain from doing *anything* that would ... deprive [the corporation] of profit or advantage which his skill and ability might properly bring to it, or enable it to make.”²²¹ By way of hyperbolic example, any sort of rest would violate this standard! Surely, the court was suggesting nothing so fanciful.

In fact, read carefully, the language in this passage is not extraordinary. Although the court spoke of “the most scrupulous observance of [a fiduciary’s] duty,”²²² that does not tell us anything about what that duty entails. The court also spoke of “an undivided and unselfish loyalty.”²²³ Because the context is a corporation rather than a partnership, it is possible to read this statement literally.²²⁴ The court, however, specified what it meant: “[T]hat there shall be no conflict between duty and self-interest.”²²⁵ Nothing is special about this statement because avoiding conflicts of interest has always been the core of the duty of loyalty. Although that remains

220. *Id.* at 510.

221. *Id.* (emphasis added).

222. *Id.*

223. *Id.*

224. Unlike a partner, who is both an agent and a principal of a partnership, see *Latta v. Kilbourn*, 150 U.S. 524, 543 (1893), an officer is only an agent of a corporation. Therefore, an officer does not need the ability to think of his own interests and can be expected to act entirely on behalf of the corporate principal.

225. *Guth*, 5 A.2d at 510. Although the court claimed that the duty of loyalty is “inveterate and uncompromising in its rigidity,” *id.*, it also undermined this strong claim when it conceded that “[a]s a general proposition it may be said that a corporate officer or director is entirely free to engage in an independent, competitive business, so long as he violates no legal or moral duty with respect to the fiduciary relation that exists between the corporation and himself,” *id.* at 514.

true to this day, the law has since changed to provide corporate fiduciaries with the ability to work around many conflicts of interest.²²⁶ This development must be kept in mind when the lofty language of older opinions is considered.

Looking beyond a few lofty passages, such as the one quoted above, reveals an opinion that is quite reasonable. This is a corporate opportunity case, and the court provided a framework for addressing such situations:

[I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity.²²⁷

This “test” is not very well formulated. Technically, it is neither a standard of conduct nor a standard of review. It is an attempt to define the term “corporate opportunity,” which the duty of loyalty prevents fiduciaries from taking for their own benefit. Although it sets forth various factors to consider, it does not suggest how the factors should be weighed.²²⁸ Nevertheless, each of the factors is perfectly reasonable, and neither lofty nor unachievable.

Like *Meinhard, Guth* is a straightforward corporate opportunity case. Nothing is especially noteworthy about the facts or the holding. At most, one might take issue with the remedy, but not with the standards that were applied.

In short, the language in cases such as *Meinhard* and *Guth* is not quite so lofty as is commonly believed. To the extent that it is lofty, it should be considered dictum rather than a standard of conduct. In each case, it is possible to go beyond the lofty language and find a

226. See DEL. CODE ANN. tit. 8, § 144 (2011). See generally Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966).

227. *Guth*, 5 A.2d at 511.

228. Read literally, the quoted language seems to suggest that all the elements must be satisfied in order to establish a corporate opportunity. However, in a subsequent passage, the court seemed to suggest that there is a corporate opportunity if any of the factors are present. See *id.* at 510-11. In fact, neither interpretation is correct. The court merely listed factors that must be considered.

core of perfectly manageable legal standards. In each case, the standard of conduct seems to be the avoidance of conflicts of interest, and the standard of review something along the lines of fairness. Although the lofty language might be considered aspirational, these familiar standards should be considered law.

Even if one is not persuaded, he nevertheless must admit that fiduciary duty standards of conduct, as typically articulated by the courts, are not nearly so lofty. It is not only possible to have standards of conduct that are capable of being enforced, it is in fact the case today. The standards of conduct for each of the main fiduciary duties²²⁹ are not only enforceable, but as a practical matter, are not even particularly demanding.

Consider first the duty of care. In Delaware, “directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances.”²³⁰ Under the Model Business Corporation Act, directors must “discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.”²³¹ These formulations, and others like them, articulate what is essentially an ordinary care standard—that is, avoid negligence. Nothing is inherently aspirational or unenforceable about this. Negligence is the relevant standard in tort law, and it is enforced in most contexts without much difficulty. In other words, the standard of conduct for the duty of care is entirely unexceptional.

Articulating the correct standard of conduct for the duty of loyalty is a bit more challenging. The duty of loyalty focuses on conflicts of interest.²³² One may be tempted to say simply that directors must avoid conflicts of interest altogether. Although this may have been the law at one time,²³³ it seems difficult to maintain today in the face of laws that specifically permit conflict of interest transactions

229. Fiduciary duties can be understood at various levels of abstraction. See Claire A. Hill & Brett H. McDonnell, *Stone v. Ritter and the Expanding Duty of Loyalty*, 76 *FORDHAM L. REV.* 1769, 1788-91 (2007). As a result, the question of how many fiduciary duties there are in corporate law—and which ones should be considered the “main” ones—is both misleading and irrelevant. See Velasco, *supra* note 148, at 1235-36.

230. *Graham ex rel. S'holders of Allis-Chalmers Mfg. Co. v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).

231. MODEL BUS. CORP. ACT § 8.30(b) (2005).

232. *Guth*, 5 A.2d at 510.

233. See Marsh, *supra* note 226, at 36-39.

under certain circumstances.²³⁴ Eisenberg has argued that the standard of conduct, like the standard of review, is fairness in the face of conflicts.²³⁵ This seems to capture the essence of loyalty in the modern corporate setting. At its broadest, the standard of conduct could be said to require that directors act in the interests of the corporation and its shareholders, as opposed to their own interests or someone else's.²³⁶ Such broad language should not suggest that the concern is altruism or selflessness, however.²³⁷ Interpreted properly, it simply requires fairness in the face of *any* conflict of interest. As such, it is not problematic. It cannot be said to be unenforceable, because fairness is also the standard of review,²³⁸ and it cannot be considered unachievable, because fairness does not require perfection.²³⁹

The duty of good faith has received serious attention only recently. As of yet, no single orthodox formulation for the standard of conduct exists. However, broadly speaking, it could be said to require honesty, decency, and compliance with law.²⁴⁰ These standards

234. See *supra* note 226 and accompanying text.

235. See Eisenberg, *supra* note 1, at 451. Eisenberg also argued that there is no divergence in the duty of loyalty. *Id.* at 450-51, 464-65. As I have argued in previous work, however, this latter assertion seems incorrect: “[T]he standard of review is significantly more limited than the standard of conduct in that it focuses primarily, if not exclusively, on financial conflicts that rise to the level of self-dealing.” Velasco, *supra* note 148, at 1243.

236. Although the duty of loyalty generally focuses on financial conflicts of interest, it also extends to related considerations. Thus, courts ask whether directors are disinterested and independent. In order to be considered disinterested, “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.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). In order to be considered independent, “a director’s decision [must be] based on the corporate merits of the subject before the board rather than extraneous considerations or influences.” *Id.* at 816. The formulation of the standard of conduct in the text reflects these twin concerns.

237. Cf. Velasco, *supra* note 148, at 1257-77 (discussing semantic differences between loyalty and good faith).

238. *But see supra* notes 3, 235 and accompanying text (describing how fairness as a standard of review is applied with limitations).

239. See *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1179 (Del. 1995) (“A finding of perfection is not a *sine qua non* in an entire fairness analysis.”); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n.7 (Del. 1983) (“[P]erfection is not possible, or expected.”).

240. Eisenberg’s articulation of the standard of conduct for the duty of good faith is as follows:

The duty of good faith in corporate law is comprised of a general baseline conception and specific obligations that instantiate that conception. The baseline conception consists of four elements: subjective honesty, or sincerity;

are by no means unachievable. They are not even particularly demanding: Although they may seem rather idealistic at first, further reflection reveals that they are common virtues. Ordinary people regularly act in good faith in their everyday lives. Nor are they inherently unenforceable. “Subjective honesty”²⁴¹ may be difficult to administer as an evidentiary matter, but this is true of many legal standards, particularly those that deal with mens rea. Thus, good faith could be enforced if the law were so inclined.

In previous work, I have argued that it may be best to say that there are five fiduciary duties.²⁴² In addition to care, loyalty, and good faith, there are also duties of objectivity and rationality.²⁴³ Under the duty of objectivity, directors must not yield to the temptations of structural bias.²⁴⁴ This duty is similar in many respects to the duty of loyalty, and likewise, is not aspirational or unenforceable. Under the duty of rationality, directors must make good business decisions. In this context, “good decisions” means well-reasoned and defensible decisions rather than decisions leading to good outcomes.²⁴⁵ Again, this is not merely aspirational, and it is not unenforceable.

Of course, standards of conduct are not enforced in corporate law.²⁴⁶ Instead, there are divergent standards of review, which enforce fiduciary duties at a much lower level. To the duty of care,

nonviolation of generally accepted standards of decency applicable to the conduct of business; nonviolation of generally accepted basic corporate norms; and fidelity to office. Among the specific obligations that instantiate the baseline conception are the obligation not to knowingly cause the corporation to disobey the law and the obligation of candor even in non-self-interested contexts.

Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 5 (2006). Although my list is shorter, it is intended to be essentially the same. By “honesty,” I mean both “subjective honesty” and “fidelity to office,” which could be considered objective honesty. *See id.* at 25 (“Fidelity to one’s office means an attempt to execute an office, and the role that the office implicates, in the manner in which execution of the office is reasonably to be expected.”). By “decency,” I mean “nonviolation of generally accepted standards [and] basic corporate norms.” *Id.* at 5. By “compliance with law,” I mean “not to knowingly cause the corporation to disobey the law.” *Id.*

241. *See supra* note 240.

242. *See Velasco, supra* note 148, at 1235.

243. *Id.* at 1288-93.

244. The standard of review is that a plaintiff must show that the directors acted unreasonably. *See id.* at 1244-48; Velasco, *supra* note 138, at 876-79.

245. The standard of review is irrationality or waste. *See Velasco, supra* note 148, at 1252-56.

246. *But see infra* Part IV.C.

a gross negligence standard applies; to the duty of loyalty, a fairness standard applies in the face of self-dealing; to the duty of good faith, an intentional misconduct standard applies; to the duty of objectivity, a reasonableness standard applies in the face of structural bias; and to the duty of rationality, a waste standard applies.²⁴⁷ It is important to keep in mind, however, the reason why this is done. As discussed earlier, it is not because standards of conduct are unimportant,²⁴⁸ nor is it because standards of conduct are unachievable. Rather, it is a policy decision made to balance competing values. Because of the limits of litigation, standards of review are lowered so that corporate governance does not interfere with the purpose of corporations—wealth generation through entrepreneurialism.²⁴⁹ Properly understood, standards of review are the outliers and standards of conduct are unexceptional.

B. The Viability of the Unenforced Requirement

In the previous Section, I argued that fiduciary duty standards of conduct are not aspirational in the sense of being unenforceable or unachievable. They are ordinary standards that could be enforced, but which we decide not to enforce for prudential reasons. Nevertheless, I insisted that they are fiduciary duties and, as such, they are mandatory and binding upon directors. This raises the question of whether an “unenforced duty” is a meaningful concept.

According to some scholars, the answer is no. Oliver Wendell Holmes famously argued that the law must be understood from the perspective of the “bad man,” for whom law is coextensive with enforcement.²⁵⁰ Although this position has some intuitive intellectual appeal, one should not mistake it for a descriptively accurate assessment.²⁵¹

247. See Velasco, *supra* note 148, at 1237-56.

248. See *supra* note 102 and accompanying text.

249. See *supra* Part II.B.

250. See *supra* note 97.

251. To rebut the Holmesian argument would be beyond the scope of this Article. See Henry M. Hart, Jr., Comment, *Holmes' Positivism—An Addendum*, 64 HARV. L. REV. 929, 932-33 (1957) (challenging Holmes). *But see* Mark DeWolfe Howe, *The Positivism of Mr. Justice Holmes*, 64 HARV. L. REV. 529, 541-42 (1951) (insisting that Holmes has been misinterpreted). See generally H.L.A. HART, *THE CONCEPT OF LAW* 79-88, 132-44 (1961) (contradicting Holmes by noting that a clear set of rules exists and that people adhere to them out of obligation rather than fear of punishment).

In fact, fear of punishment is only one factor that motivates people to obey the law. In his book, *Why People Obey the Law*, Tom R. Tyler argues that there are least four factors that motivate people.²⁵² The first is the instrumental perspective—essentially, fear of punishment.²⁵³ The second and third, which are very different from the first, are the “normative perspectives” of personal morality and legitimacy:²⁵⁴ “[P]ersonal morality means obeying a law because one feels the law is just; ... legitimacy means obeying a law because one feels that the authority enforcing the law has the right to dictate behavior.”²⁵⁵ A fourth factor is social relations, or a concern with the social consequences of one’s actions.²⁵⁶ Tyler distinguishes the four as follows:

Consider a specific illegal activity such as using cocaine. What is a person’s motivation for complying with the law prohibiting its use? If people refrain from using drugs because they think laws ought to be obeyed, then legitimate authority is influencing their behavior. If they do so because drug abuse violates their convictions, then personal morality is influencing their behavior. If they fear being caught and sent to prison, deterrence is influencing their behavior. And if they do not use drugs because they fear the disapproval of their friends, the social group is exerting its influence.²⁵⁷

The unenforced duty may not be a meaningful concept for those who are motivated solely by fear of punishment. Because there is no punishment, there is no reason to obey the law. However, few people, if any, are motivated solely by the fear of punishment, or any one factor. People are complex and are motivated by different concerns to varying degrees. Thus, even one who is motivated primarily by fear of punishment is likely influenced by other concerns as well. Even one who is motivated solely by fear of punishment may have to factor in the possibility that the unenforced duty may be enforced after all. As argued in the previous Section, the standard of conduct is potentially enforceable. The

252. TOM R. TYLER, *WHY PEOPLE OBEY THE LAW* 3-5 (2006).

253. *Id.* at 4.

254. *Id.*

255. *Id.*

256. *Id.* at 23-24.

257. *Id.* at 25.

Disney trial court's statements to the contrary notwithstanding,²⁵⁸ laws do change over time. Therefore, one could conclude that there is more to fear from a "currently unenforced" duty than from a mere aspirational ideal.²⁵⁹

The unenforced duty becomes significantly more meaningful when the other motivating factors are taken into consideration. This is most obvious with respect to legitimacy: "People generally feel that existing legal authorities are legitimate, and this legitimacy promotes compliance with the law."²⁶⁰ Empirically, "legitimacy has a significant independent effect on compliance, even when other potential causal factors are controlled for."²⁶¹ Tyler's study found that legitimacy can be a factor even more significant than deterrence.²⁶² Stanley Milgram's well-known study of obedience to authority suggests how powerful the influence of legitimacy can be.²⁶³ Milgram described his experiment as follows:

I set up a simple experiment at Yale University to test how much pain an ordinary citizen would inflict on another person simply because he was ordered to by an experimental scientist. Stark authority was pitted against the [participants'] strongest moral imperatives against hurting others, and, with the [participants'] ears ringing with the screams of the victims, authority won more often than not. The extreme willingness of adults to go to almost any lengths on the command of an authority constitutes the chief finding of the study.²⁶⁴

Setting aside the issue of its significance relative to deterrence, legitimacy surely is an important factor leading to voluntary compliance with law. Moreover, it seems difficult to imagine that corporate fiduciaries would not consider the courts a legitimate authority. Thus, if the courts declare standards of conduct to be law—mandatory and binding—then one can expect at least some

258. See *supra* note 65 and accompanying text.

259. See *infra* Part IV.C (arguing that standards of conduct are not unenforced, but underenforced).

260. TYLER, *supra* note 252, at 170.

261. *Id.* at 58-59; see also *id.* at 57-68 (studying the effects of legitimacy on compliance).

262. *Id.* at 270 ("In fact, the findings of this study suggested that legitimacy was more influential than was the risk of being caught and punished for rule breaking."); see also *id.* at 58-60 (detailing the results of the legitimacy study).

263. See STANLEY MILGRAM, *OBEDIENCE TO AUTHORITY: AN EXPERIMENTAL VIEW* (1974).

264. Stanley Milgram, *The Perils of Obedience*, HARPER'S MAG., Dec. 1973, at 62, 62.

voluntary compliance by fiduciaries. By comparison, if the courts define standards of conduct as aspirational—optional and perhaps unachievable—then fiduciaries might be less inclined to comply. After all, the courts' expertise is law, not morality.

Personal morality also plays a role in compliance with law. At first, one might think that this factor would be irrelevant as to the unenforced duty. After all, one's personal morality should be internalized and not dependent upon legal labels, such as "unenforced duty" and "aspirational ideal." People also are unlikely to have particularly strong moral convictions with respect to corporate law, at least by comparison to more controversial areas such as criminal law or constitutional law. However, "[p]eople generally feel that law breaking is morally wrong, and that they have a strong obligation to obey laws even if they disagree with them."²⁶⁵ Therefore, it may be effective to consider standards of conduct to be law rather than aspirational ideals. Moreover, people's internal views are much more likely to be consistent with standards of conduct than opposed to them. Surely, few people would feel a moral obligation to be negligent, unfair, or dishonest. To the contrary, they probably believe that they ought to be careful, fair, and honest—even if it is not terribly important in the corporate context. Finally, the law may be able to influence personal morality. Many people believe that the law has an expressive and pedagogical function, and that it can tell people not only what they must do, but also what they should do.²⁶⁶ Thus, people may be more inclined to believe that a given action is morally acceptable if it is legal and to believe that it is morally unacceptable if it is illegal.²⁶⁷ Therefore, declaring standards of conduct to be law may have an expressive or pedagogical benefit on compliance. In short, personal morality is a factor that weighs in favor of the significance of unenforced duties.

Finally, people may be motivated to obey the law based on social consequences. Although many might consider this a variant of the

265. TYLER, *supra* note 252, at 64; *see id.* at 56.

266. For discussions of the expressive effect of law, see generally Lawrence Lessig, *Social Meaning and Social Norms*, 144 U. PA. L. REV. 2181 (1996); Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338 (1997); and Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021 (1996).

267. *See, e.g.*, Robert E. Goodin, *An Epistemic Case for Legal Moralism*, 30 OXFORD J. LEGAL STUD. 615, 629 (2010) (noting that citizens may rely on the inference that illegality and immorality are coextensive).

instrumental perspective—with consequences being social rather than legal—Tyler considers it a hybrid.²⁶⁸ Importantly, he finds that this factor tends to be linked closely with personal morality.²⁶⁹ It should similarly support the meaningfulness of the unenforced duty. This makes intuitive sense: presumably, one would risk greater disapproval for failure to comply with a law than he would for failure to live up to an aspirational ideal.

To be sure, fear of punishment is one important factor that motivates people to comply with the law. But it is not the only factor, and may not even be the most important factor.²⁷⁰ Even though the lack of enforcement would tend to reduce the effectiveness of legal standards of conduct, it should still be beneficial from a compliance perspective for such standards to be considered law, and therefore mandatory and binding upon fiduciaries.

The recent work of Professor Lynn Stout is consistent with Tyler's conclusions. In her recent book, *Cultivating Conscience: How Good Laws Make Good People*, Stout argues that people generally are not the selfish beings that the term *homo economicus* suggests.²⁷¹ Although people can be selfish, they also are capable of prosocial and unselfish behavior—and, in fact, engage in it regularly.²⁷² Of particular relevance is the model of human behavior that she proposes:

Unselfish prosocial behavior toward strangers, including unselfish compliance with legal and ethical rules, is triggered by social context, including especially:

- (1) instructions from authority;
- (2) beliefs about others' prosocial behavior; and
- (3) the magnitude of benefits to others.

Prosocial behavior declines, however, as the personal cost of acting prosocially increases.²⁷³

268. See TYLER, *supra* note 252, at 23-24. *But cf. supra* note 43 and accompanying text (discussing how fear of any type of sanction is essentially a deterrent akin to fear of punishment under the instrumental perspective).

269. TYLER, *supra* note 252, at 239 n.6.

270. See *supra* notes 252-59, 262-65 and accompanying text.

271. See generally LYNN STOUT, *CULTIVATING CONSCIENCE: HOW GOOD LAWS MAKE GOOD PEOPLE* 23-44 (2011) (discussing *homo economicus*).

272. See *id.* at 51-71.

273. *Id.* at 99 (emphasis omitted).

Among the reasons that she emphasizes these three variables is that “each of the three variables maps onto one of three universal and well-studied traits of human nature. These three basic psychological traits are: *obedience* to authority; *conformity* to the behavior of those around us; and *empathy* for others.”²⁷⁴ Stout’s conclusion that people are motivated by factors beyond mere cost-benefit analysis provides additional support for the meaningfulness of the unenforced duty.

The first factor that Stout argues promotes “[u]nselfish prosocial behavior[,] ... including unselfish compliance with legal and ethical rules,” is “instruction[] from authority.”²⁷⁵ This maps on to the psychological trait of obedience. I submit that standards of conduct provide a stronger and clearer instruction from authority when they are deemed mandatory law than when they are called aspirational ideals—that is, when they are considered obligatory rather than optional. To be fair, Stout’s model is sufficiently robust to allow for “instructions” in the form of suggestions rather than mandates, and it covers “ethical rules” as well as legal ones.²⁷⁶ Clearly, it is better to suggest that directors *ought* to act a certain way than not to do so. However, to insist that they *must* act a certain way is better than to suggest that they *should*. Thus, the unenforced duty is a meaningful concept.

Stout’s second factor is “beliefs about others’ prosocial behavior,” which maps on to the psychological trait of conformity.²⁷⁷ Whether standards of conduct are deemed mandatory or aspirational should have no direct bearing on this factor. However, it may very well have a strong indirect effect. For the same reasons that people are more likely to comply with a mandatory rule than an aspirational ideal, they are also likely to assume that others will do the same. Out of sheer conformity, then, a mandatory rule could lead to greater compliance than an aspirational ideal.

Stout’s third factor, “the magnitude of the benefits to others,”²⁷⁸ is unlikely to be affected—either directly or indirectly—by the legal designation of standards of conduct as either mandatory or aspi-

274. *Id.* at 102.

275. *Id.* at 99; *see also id.* at 102-06.

276. *See id.* at 104-05.

277. *See id.* at 99; *see also id.* at 106-10.

278. *See id.* at 99; *see also id.* at 110-14.

rational.²⁷⁹ Stout also identifies a fourth social variable, “social distance,” or the degree of connection between the actor and others affected by his behavior.²⁸⁰ This factor likely weighs against compliance with fiduciary duties because shareholders are generally fairly distant to directors. However, the legal designation of standards of conduct as either mandatory or aspirational has no bearing on the issue, so this factor does not weigh against the meaningfulness of the unenforced duty.

Stout also acknowledges that “prosocial behavior declines ... as the personal cost of acting prosocially increases.”²⁸¹ In other words, a cost-benefit analysis matters.²⁸² The threat of enforcement would be very likely to increase compliance. That does not mean that an unenforced duty would be ignored. Stout’s work suggests that factors other than personal cost also weigh in an actor’s decision, and this provides support for the meaningfulness of the unenforced duty.

In the world of corporate law, the meaningfulness of the unenforced duty is generally accepted. Courts and scholars generally agree that directors will comply with fiduciary duty standards of conduct even without the threat of legal enforcement. There are many different reasons why this might be true. The three main theories are based on markets, morality, and norms, and align well with three of the four theories discussed above. Market theories are an instrumental perspective, with the fear of punishment focusing on market forces rather than legal enforcement.²⁸³ The theory suggests that market forces constrain directors’ ability to shirk or misbehave and compel them to do a good job.²⁸⁴ Morality theories rely on personal morality. They suggest that directors will internal-

279. It may not be entirely fanciful to imagine that such designation may imply a conclusion. Presumably, a matter cannot be too serious if it leads to a rule that is only aspirational, and cannot be frivolous if it leads to a mandatory rule. Of course, whether the implication would actually affect an actor’s calculus is beyond the scope of this Article.

280. STOUT, *supra* note 271, at 101.

281. *Id.* at 99.

282. *Id.* at 114-115.

283. See Blair & Stout, *supra* note 37, at 1748.

284. See, e.g., *id.* at 1737; Charles M. Elson & Robert B. Thompson, Van Gorkom’s *Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives*, 96 NW. U. L. REV. 579, 580-82 (2002) (“Product markets indirectly constrain managers’ decisions, as do the capital market, the market for managerial services, and the market for corporate control.”); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 262-73 (1977) (discussing constraint on management control created by market forces including stock price).

ize the norms underlying standards of conduct and therefore comply with them voluntarily.²⁸⁵ Norms theories rely on social relations. They suggest that directors generally will comply with societal norms, if only to win the esteem of others and avoid informal sanctions.²⁸⁶ Each of these forces has the effect of fostering compliance with unenforced standards of conduct.

Nevertheless, there is an important limitation in these theories as they are employed in corporate law scholarship. In short, market forces, morality, and social norms are not enough. In combination with a legal duty, however, they lead to greater compliance.²⁸⁷

Consider first morality theories. Because of their personal morality, directors can be expected to internalize societal expectations and comply with standards of conduct voluntarily. In general, people like to think of themselves as good people who follow the rules;²⁸⁸ but there are limits to people's willingness to comply with societal expectations. One obvious limit is that people are less willing to comply when the cost of compliance significantly outweighs the benefits of noncompliance.²⁸⁹ I suggest that another important limit is that people are more willing to comply with mandatory rules than with optional rules. Although most people would like to be considered decent, not everyone would care to be considered saintly. Similarly, whereas most people would like to satisfy their obliga-

285. See, e.g., Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1505 (1989) ("Many or most managers will probably act in the shareholders' interests, even if not constrained to do so by market mechanisms, because they have internalized the moral principles of corporate stewardship."); see also *supra* notes 98-99 and accompanying text.

286. See, e.g., Rock, *supra* note 16, at 1010-14; Rock & Wachter, *supra* note 21, at 1641 ("Some [NLEERS] are enforced by third parties through the application of peer pressure, shaming, or threats to one's reputation.").

287. "Taken separately, neither markets, morals, nor law are in themselves sufficient to curb traditional and positional conflicts. Taken together, however, markets, morals, and law have shown themselves capable of achieving that objective." Eisenberg, *supra* note 285, at 1525.

288. See *supra* note 99 and accompanying text; see also William T. Allen, *20th Century Evolution and Growth of Delaware Corporation Law*, DEL. LAW., Winter 1999/2000, at 16, 20 ("Corporate directors ... will even prefer to incur some cost to be able to say to themselves (and their families) that they have done the right thing."); Blair & Stout, *supra* note 37, at 1750-51 (discussing constraints on behavior that arise from individuals' desire to act with integrity).

289. See, e.g., Blair & Stout, *supra* note 37, at 1774 ("Studies have found that, while people do cooperate in social dilemma games, as the personal cost associated with cooperating rises (that is, as players' expected gains from defection increase), cooperation rates begin to decline.").

tions, not everyone would care to go above and beyond the call of duty. Thus, from the perspective of morality, we can expect greater compliance with rules that are considered mandatory than with those that are considered optional.

The same limitation applies with respect to market theories and norms theories, although it is perhaps less obvious. Market forces and informal sanctions limit directors' ability to engage in misconduct. These forces only go so far, however. They are more likely to punish illegal behavior than to require virtuous behavior. Thus, they are more likely to demand compliance with a legal duty than with an aspirational ideal.

Finally, legitimacy can be an independent basis of compliance by directors. Even where market forces, personal morality, and social norms fall short, directors may nevertheless feel obligated to comply with their legal duties. The same cannot be said of aspirational ideals.

The limits of market forces, morality, and social norms are particularly significant in important corporate law situations. Fiduciary duties exist to prevent directors from profiting at the expense of shareholders, whether by shirking, self-dealing, or otherwise.²⁹⁰ There is always an incentive to breach fiduciary duties, and often the incentives are significant. To label fiduciary duty standards of conduct as aspirational ideals will reduce directors' incentives to behave. When faced with a choice between compliance and personal profits, directors will find it easier to rationalize a self-serving decision. Conflicted directors, when weighing the costs and benefits of compliance, may conclude that aspirational and unenforceable standards of conduct are not only optional, but possibly unreasonable and even simply wrong. This may severely impede the process of internalization by directors; if widespread, this attitude may undermine the social norm among the relevant peer group—other directors.²⁹¹ Such rationalization would be significantly more difficult in the face of a clear legal duty. Although some misconduct

290. See, e.g., D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1482 (2002) (“[T]he purpose of fiduciary duty is to combat opportunism.”).

291. See, e.g., TYLER, *supra* note 252, at 24 (“Group influence may also exert normative pressure on people, because individuals look to their social groups for information about appropriate conduct.... People’s behavior is strongly affected by the normative climate created by others.”).

will always persist, greater compliance can be expected if standards of conduct are considered legal duties.

In short, the unenforced duty is a meaningful concept. Psychological studies suggest that fear of punishment is only one factor motivating compliance with law.²⁹² Legitimacy, personal morality, and social relations are also factors.²⁹³ Corporate law generally accepts the premise behind the unenforced duty; in fact, it relies upon voluntary compliance by directors. Such voluntary compliance, however, is much more likely to follow a legal duty than an aspirational ideal.

C. Is There Enforcement After All?

Throughout this Article, I have assumed that standards of conduct reflect unenforced duties. However, this is not the only plausible interpretation. In this final Section, I will suggest that standards of conduct reflect not unenforced duties, but *under-enforced* duties.

As I have argued in previous work, fiduciary duties can be thought of in many different ways, none of which is necessarily more valid than the others.²⁹⁴ Thus, for example, depending upon the level of abstraction used to view fiduciary duties, it is equally valid to say that there is only one fiduciary duty, or two, or three, or five, or virtually any number.²⁹⁵ Likewise, it is possible to view standards of conduct and standards of review as different fiduciary duties. Implicitly, this is the sense in which the Article has discussed fiduciary duties thus far: standards of review are those fiduciary duties that are enforced, and standards of conduct are those fiduciary duties that are not enforced.

Under another view, standards of conduct and standards of review are not different fiduciary duties at all. Rather, both are aspects of the same fiduciary duty. Each fiduciary duty therefore has a standard of conduct and a standard of review associated with it. Under this view, fiduciary duties are not enforced to the fullest extent possible—that is, the standards of conduct—but only to a lesser extent—the standards of review. Thus, it is not appropriate

292. *Id.* at 3-5.

293. *Id.*

294. *See generally* Velasco, *supra* note 148.

295. *See id.* at 1285-88.

to say that standards of conduct represent unenforced duties and standards of review represent enforced duties. A more appropriate description would be that standards of conduct represent the limit of fiduciary duties, and standards of review represent the extent to which they are enforced.

Viewed in this light, the problem of the unenforced duty disappears. After all, no law is perfectly enforced. Perfect enforcement is prohibitively expensive.²⁹⁶ For every law, society must make two important decisions: the substantive content and the level of enforcement. Often, the enforcement issue is resolved by deciding upon the number of policemen there should be. With more policemen, greater enforcement becomes possible. Sometimes, however, the issue is dealt with by deciding upon the tools that shall be available for enforcement. A common example would be the decision of whether to allow private causes of action. If private action supplements government action, greater enforcement is possible.²⁹⁷ However, other tools also affect the level of enforcement. Pleading standards and evidentiary burdens certainly have a significant, albeit indirect, effect. Corporate law uses all of these tools, and goes a bit further by creating a divergence between standards of conduct and standards of review. Ultimately, however, the divergence is just another tool that the law uses to determine the appropriate level of enforcement.²⁹⁸

In short, the difference between corporate law and other bodies of law is actually one of degree rather than kind. Like any other body of law, corporate law has decided upon methods appropriate for

296. George J. Stigler, *The Optimum Enforcement of Laws*, 78 J. POL. ECON. 526, 526-27 (1970); see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 563-64 (6th ed. 2003) (discussing the cost of enforcement in the context of procedural due process).

297. See *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) (“Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission’s acceptance of the representations contained therein at their face value, unless contrary to other material on file with it.”).

298. As previously discussed, the divergence is largely a manifestation of the business judgment rule, see *supra* notes 140-62 and accompanying text, which the courts call a “presumption.” A comprehensive understanding of the divergence would add the concepts of pleading standards and evidentiary burdens, but these are all typical litigation devices.

enforcement, even if imperfect. Like all law, fiduciary duties are not *unenforced*, but *underenforced*.

A simple thought experiment should help to demonstrate that standards of conduct really are underenforced fiduciary duties rather than unenforced duties. Earlier in this Article, I argued that the divergence is ultimately rooted in the limits of litigation.²⁹⁹ I now suggest that if those limits could be eliminated, standards of conduct would be enforced.

How can the limits of litigation be overcome? Fortunately, it is easier than one might suspect. All that is required is the elimination of the fact-finding and fact-characterization process, which is prone to error. This can be done by a stipulation of the facts. Assume that the parties to a case agree that the directors satisfied the standard of review but knowingly failed to satisfy the standard of conduct. I submit that the director would—or at least should—be held liable for breach of fiduciary duty.

The easiest case to illustrate is the duty of care. Assume that a director knew he was behaving negligently, but the parties agree that he was not grossly negligent. At first glance, it might seem odd to suggest that someone could be “knowingly negligent.” In fact, there is nothing problematic about the suggestion. For example, assume that the director has to review a merger agreement before the board meeting at which he must vote on a merger. The director knows that, given his abilities, he must spend ten hours reviewing the document to understand it adequately. Even so, he knows that he can get by with a quick, one-hour review. By his own admission, ten hours is the threshold for negligence, and one hour is the threshold for gross negligence. Knowing this, he spends three hours reviewing the document. He is clearly negligent, but clearly not grossly negligent. Because he is fully aware of this at the time he acts, he is knowingly negligent in his duties.

A similar hypothetical could be crafted for the duty of loyalty. Assume a conflict of interest transaction in which a director acts in a way that could be defended as fair, but which the director believes was not actually in the interests of the shareholders. For example, the director buys property from or sells property to the corporation at the price specified by an impartial appraiser, but which he believes is a bad deal for the corporation. Again, the director might

299. See *supra* Part II.B.

satisfy the entire fairness test, but he would not be acting in the interests of shareholders.³⁰⁰

In either case, I submit that the director would be held liable for breach of fiduciary duty, assuming, with respect to the duty of care example, that there is no exculpation provision in the corporate charter. With certitude that the director violated the standard of conduct based on his own admission, a court would have no reason not to hold him liable.³⁰¹ Liability would not interfere with the goals of the business judgment rule.

Of course, I may be wrong. Without precedent, it is difficult to predict a judicial response with any confidence. Perhaps all that I can say based on the above facts is that the courts *should* hold directors liable. Nevertheless, if I am wrong, I am not off the mark by much. With only a minor change in the facts assumed above, I am confident that the courts *would* enforce the standard of conduct. That minor change would be to change the directors' mens rea from knowing to intentional.³⁰²

In the first hypothetical above, assume that the director not only knows that he should spend ten hours reviewing the documents and fails to do so, but actually intends to spend only three hours. In other words, he does not get sidetracked with other matters, but rather decides to spend only three hours on the job so that he can spend the other seven hours playing golf. He is intentionally negligent, but avoids gross negligence. In this case, it can be said with

300. As I have suggested elsewhere, it is fair to say that there are five fiduciary duties. See Velasco, *supra* note 148, at 1288-93. In addition to care and loyalty, there are good faith, objectivity, and rationality. *Id.* Similar hypotheticals could be devised for the three additional duties. For the duty of good faith, a director could satisfy the standard of review but not the standard of conduct by not putting in much effort but avoiding intentional misconduct. For the duty of objectivity, a director could do so by reaching a conclusion that is defensible as reasonable even though it is in fact calculated to benefit management. And for the duty of rationality, a director could do so by reaching a decision that does not benefit shareholders but cannot be characterized as waste.

301. The only reason not to do so at that point is for fear of the precedential value for other cases in which the evidence is not so clear. Although that may be a legitimate institutional concern, it is based on the limits of litigation, rather than the merits. My hypothetical assumes away such concerns in order to make a substantive point.

302. "Knowing" generally means "[h]aving or showing awareness or understanding; well-informed." BLACK'S LAW DICTIONARY 950 (Bryan A. Garner ed., 9th ed. 2009). "Intentional" means "[d]one with the aim of carrying out the act." *Id.* at 883. Intentional acts are done knowingly, but knowing acts need not be intentional. *Cf.* MODEL PENAL CODE § 2.02(2)(a)-(b) (Proposed Official Draft 1962) (distinguishing between "knowingly" and "purposely").

confidence that he would be found liable. Why is that? It is because the director would be guilty of an intentional dereliction of duty—that is, intentional misconduct—and thus would be in violation of the standard of review for the duty of good faith.³⁰³

In other words, fiduciary duty standards of conduct may be enforced through the duty of good faith. Although this will be true only in extreme circumstances—when the misconduct is intentional—that is a reasonably appropriate condition given the limits of litigation that prompt the business judgment rule. To be clear, I do not mean to suggest that the *purpose* of the duty of good faith is to enforce other standards of conduct. To the contrary, this conclusion is based on fairly recent pronouncements on the duty of good faith.³⁰⁴ Nevertheless, it is a perfectly natural development that ties together various concepts of the law relating to fiduciary duties.

The business judgment rule is considered a presumption of good faith on the part of directors.³⁰⁵ Based on this “powerful presump-

303. See *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 66-67 (Del. 2006) (upholding “intentional dereliction of duty, a conscious disregard for one’s responsibilities” as “a legally appropriate, although not the exclusive, definition of fiduciary bad faith”), *aff’d* 907 A.2d 693 (Del. Ch. 2005). This may seem inconsistent with other portions of the various *Disney* opinions. For example, the supreme court took great effort to draw a “distinction between conduct that is negligent (or grossly negligent) and conduct that is intentional.” *Id.* at 66 n.109. However, the court’s point is that conduct that is merely negligent (or grossly negligent) cannot automatically be considered intentional or in bad faith. In my hypothetical, it is not the negligence that can lead to liability, but rather the intent that constitutes bad faith. Similarly, my conclusion may seem at odds with the holding of *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), where the court seemed to require an “utter failure” to reach the level of bad faith, *id.* at 369. However, *Stone* is not a problem for two reasons. First, the *Stone* case dealt only with director oversight “where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation.” *Id.* (quoting *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996)). My hypothetical does not involve oversight. Second, the *Stone* case did not purport to provide an exclusive definition of bad faith. To the contrary, the court cited to, and drew from, the *Disney* opinion extensively. What both *Stone* and *Disney* require is “that a failure to act in good faith requires conduct that is qualitatively [—not quantitatively—] different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence).” *Id.* (citations omitted). As the court in *Stone* acknowledged, “[w]here directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.” *Id.* at 370 (citations omitted). My claim is that intentional negligence is a conscious disregard of responsibilities, or intentional misconduct, that constitutes bad faith and could lead to liability.

304. See *Disney*, 906 A.2d at 62-68; *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 695, 753-56, 772-79 (Del. Ch. 2005), *aff’d*, 906 A.2d 27.

305. See *supra* notes 141-44 and accompanying text.

tion,” plaintiffs bear the burden of establishing a breach of fiduciary duty.³⁰⁶ However, the business judgment rule also *depends upon* the directors’ good faith. Therefore, if the presumption is rebutted and it is established that directors are not acting in good faith—for example, because they are engaging in intentional misconduct—then they are not protected by, and do not deserve the benefits of, the business judgment rule.³⁰⁷ The standards of conduct can be enforced. There is no reason to shield directors from the consequences of their malfeasance, and there are no competing values or incentive issues to weigh.³⁰⁸ Directors who are engaged in intentional misconduct deserve to be held accountable.

Thus, we can say that even the standard of conduct is not entirely unenforced. For good reasons—based on the limits of litigation—fiduciary duties are underenforced. In an appropriate case, when those good reasons are absent, the courts could, should, and arguably would, enforce standards of conduct. In short, standards of conduct are not unenforceable, or even unenforced, but only underenforced. This is a fate shared, to different extents, by all laws.

CONCLUSION

According to the aspirational view of fiduciary duties, standards of review represent law, whereas standards of conduct represent aspirational ideals. My goal in this Article has been to rebut this view and hopefully arrest its growing popularity. Fiduciary duties encompass both standards of conduct and standards of review. Both are law, even if only the latter tend to be enforced legally. Because standards of conduct represent fiduciary duties, they are obligatory upon directors.

Standards of conduct may be unenforced or underenforced, but they are not unenforceable. The law assumes that directors will comply with standards of conduct even without the threat of legal enforcement. Because of this “voluntary” compliance, legal enforce-

306. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

307. *See id.* (“To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the *triads* of the their fiduciary duty—good faith, loyalty or due care.”).

308. One possible reason to rule in favor of directors is for fear of the precedential value that a holding of liability might have in future, less clear cases. However, such a decision would not be based on the merits, but on the limits of litigation. *See supra* Part II.B.

ment is not necessary.³⁰⁹ If such compliance ceases or wanes, however, legal enforcement may become necessary. In other words, the aspirational view is on a collision course with itself. If directors come to believe the claim that standards of conduct are merely aspirational, then they can be expected to reduce their compliance over time. At some point, the courts would have to step in and enforce the standards of conduct. If this were to happen, standards of conduct would no longer be merely aspirational, and the benefits of the divergence will be lost.

The better view of fiduciary duties is to recognize that, although aspiration plays a role, it has nothing to do with the divergence between standards of conduct and standards of review. Standards of conduct reflect what we expect and demand of directors, whereas standards of review reflect what we will hold them accountable for. In order to fulfill their fiduciary duties, directors must comply with both. Aspirational ideals are those that go above and beyond the call of duty. Such behavior can be encouraged and praised, but never required or enforced.

309. Velasco, *supra* note 148, at 1239; Velasco, *supra* note 138, at 834.