Recalling Why Corporate Officers Are Fiduciaries

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RECALLING WHY CORPORATE OFFICERS ARE FIDUCIARIES

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[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?¹

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INTRODUCTION

Chief executive officers wield enormous power in the modern corporation. Such well-known names as Michael Eisner at the Walt Disney Company, Martha Stewart, formerly at Martha Stewart Living, Dick Grasso, formerly head of the New York Stock Exchange, and Dennis Kowzowski, formerly at Tyco, embody the influence of the modern CEO. When they and other senior officers perform well, the enterprise and its stockholders are likely to flourish; when they misbehave—as many have in recent years—the company, stockholders, creditors, employees, and others in society suffer significant loss. Recent concern about officer wrongdoing has resulted in numerous federal and state criminal charges, the initiation of Securities and Exchange Commission (SEC) administrative proceedings, and imposition of new federal responsibilities on officers through the Sarbanes-Oxley Act. At the same time, Congress, the SEC, the New York Stock Exchange (NYSE), and

2. See, e.g., Scandal Scorecard, WALL ST. J., Oct. 3, 2003, at B1 (detailing criminal charges and investigations against various corporate officers). A timely analysis of conditions contributing to corporate corruption in the 1990s is provided by Professor Lawrence Mitchell. See LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY (2001); see also Lisa M. Fairfax, Form over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability Under the Sarbanes-Oxley Act, 55 RUTGERS L. REV. 1, 4-15 (2002).


4. See id.


6. The Sarbanes-Oxley Act, supra note 5, contains a number of provisions affecting corporate directors. For example, section 301(m)(3) includes a requirement that audit committee members be independent (amending 15 U.S.C. § 78f (Supp. 2003)); section 407 directs the SEC to issue rules requiring public companies to disclose whether the audit committee is comprised of at least one member who is a financial expert (15 U.S.C. § 7265 (Supp. 2003)); section 202 requires that all audit and non-audit services provided by the auditor be pre-approved by the audit committee (15 U.S.C. § 78j-1 (Supp. 2003)); and section 402 forbids public companies from making loans to directors and executive officers (amending 15 U.S.C. § 78m (Supp. 2003)). These and other provisions affecting both directors and officers are described in greater detail in Lyman P.Q. Johnson & Mark A. Sides, The Sarbanes-Oxley Act and Fiduciary Duties, 30 WM. MITCHELL L. REV. 1149 (2004).

7. The SEC has promulgated many rules regulating corporate directors under Sarbanes-Oxley. A complete description of these rules is beyond the scope of this Article. See generally Johnson & Sides, supra note 6 (describing SEC rules under Sarbanes-Oxley).

8. The most important rules promulgated recently by the NYSE, and approved by the
the Nasdaq⁹ all have prescribed new functions for boards of directors and their committees. These initiatives, taken together, aim to improve the overall functioning of corporate governance in public corporations, at both the director level and the officer level. This is not only a response to the widespread rash of recent corporate scandals, but also the latest—and most dramatic—episode in a larger effort to restore a healthy governance relationship between corporate directors and corporate officers.

For all the renewed federal attention to regulating—and differentiating—corporate officer and director functions, however, a curious fact remains: state fiduciary duty law makes no distinction between the fiduciary duties of these two groups. Instead, courts and commentators routinely describe the duties of directors and officers together, and in identical terms.¹⁰ To lump officers and

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⁸ The most important new Nasdaq rules, approved by the SEC on November 4, 2003, deal with the definitions and role of independent directors through amendments to Nasdaq Rules 4200 and 4350. The aim of the amendments is "to provide greater transparency regarding the definition of independence and to increase the roles and responsibilities of independent directors and independent board committees." Letter from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Securities and Exchange Commission, attach. at 2 (Oct. 9, 2003), available at http://www.Nasdaq.com/about/SR-NASD-2002-141_Amendment_3.pdf (last visited Feb. 28, 2005); see also Johnson & Sides, supra note 6, at 1168-74 (describing Nasdaq rules).

¹⁰ The foundational case on corporate fiduciary duties in Delaware states: "Corporate officers and directors ... stand in a fiduciary relation to the corporation and its stockholders." Guth v. Loft, 5 A.2d 503, 510 (Del. 1939). Later, the Delaware Supreme Court quoted the following generalization approvingly: "Practically all jurisdictions recognize a fiduciary relationship arising from the directors and officers to their corporation and to the stockholders ...." Lynch v. Vickers Energy Corp., 429 A.2d 497, 502-03 (Del. 1981) (quoting Mansfield Hardwood Lumber Co. v. Johnson, 263 F.2d 748, 754 (5th Cir. 1959)). More recently, Chancellor William Chandler, noting this current state of the law, stated: "(t)o date, the fiduciary duties of officers have been assumed to be identical to those of directors." In re Walt Disney Co. Derivative Litig., C.A. No. 15452, 2004 WL 2050138, at *3 (Del. Ch. Sept. 10, 2004).

A leading corporate law treatise puts the matter as follows: "[C]orporate directors and officers occupy a fiduciary capacity.... To a great extent, the rules governing liability are the same whether the officer sued is a director or some other officer such as the president, vice president, secretary ...." WILLIAM MEADE FLETCHER, 3 FLETCHER CYCLOPEDIA OF THE LAW OF
directors together as generic "fiduciaries," with no distinction being made between them, suggests—as patently is not the case—that their institutional function and legal roles within the corporation are the same. Such a view, consequently, undermines efforts to distinguish more sharply, not blur, the governance responsibilities of these two groups.

Failure to differentiate the duties of officers, who daily manage corporate operations, from directors, who more remotely monitor corporate affairs, stems from a puzzling failure to address an even deeper issue in corporate law: What exactly is the theoretical and conceptual basis for the widespread claim that corporate officers owe fiduciary duties to a corporation and its stockholders? In other words, to Justice Frankfurter's list of good questions to ask about fiduciary status, we can add another: Why do corporate officers owe fiduciary duties? Hardly a week goes by without yet another Delaware decision addressing the subject of director duties. Yet, surprisingly, no Delaware decision has ever clearly articulated the subject of officer duties and judicial standards for reviewing their discharge. For persons occupying such central places of power in corporations, senior officers have largely succeeded in eluding the distinctive attention of state corporation law. This is a puzzling void.

The thesis of this Article is that corporate officers are fiduciaries because they are agents. The rules and rationales of agency principles—an entire body of law virtually ignored in corporate governance—provide a coherent beginning point for systematically developing both the reasons for, and the nature of, officer fiduciary duties. Our argument is not that agency principles should be introduced formalistically or uncritically into corporate governance. Rather, the claim, first, is that drawing on the fiduciary
duties of agents for guidance in fashioning modern understandings of corporate officer duties—and differentiating those duties from those of directors—can provide much needed structure to what otherwise threatens to be an ad hoc enterprise. Of course, an agent's fiduciary duties being broadly sketched, they can be given shape and content only in particular contexts. This case-by-case “fleshing out” of officer duties must be done consistently with appropriate expectations for senior officers in the early twenty-first century.

Second, providing a conceptual basis both to ground officer fiduciary obligations and to distinguish director and officer functions can substantially enhance the larger project of restoring to reality the legal model of director-officer relations within the public corporation. In this model, directors delegate to officers, acting as agents, the role of managing the business and affairs of the corporation. Although such delegation is entirely proper, both functionally and as fiduciaries, directors must preserve for themselves a critical governance responsibility on behalf of the corporate principal and its stockholders—monitoring the managerial performance of officer-agents. This division of labor within corporate governance is essential because organizational principals—be they corporations, churches, universities, or other groups—differ from individual principals. Having rightly delegated management of an organization to agents, too often members of the governing body fail to do what individual principals do for themselves, but what an organization (lacking human capacity) cannot do: continue to monitor and evaluate the persons to whom management has been delegated. Agency law illuminates the nature of this director-officer interaction and highlights how dysfunctional boards contributed to recent governance scandals. Corporate interests were left unprotected as officers operated free of any meaningful director supervision.

What are the benefits of our thesis? First, by understanding officer duties and director-officer interaction in this way, it can be seen that state law remains the primary source for establishing the basic framework of corporate governance relations, both through corporate statutes and through judge-made fiduciary duty law. With

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12. See infra Part II.C.
a more highly differentiated state law model of director-officer relations, recent efforts of Congress,\textsuperscript{13} the SEC,\textsuperscript{14} the NYSE,\textsuperscript{15} and Nasdaq\textsuperscript{16} to impose new responsibilities on directors—designed to improve their vital role in monitoring corporate officers—can be understood as congruent with, rather than at odds with, the underlying state law framework. The current emphasis on director independence and the special focus on various board committees—audit, nominating/governance, and compensation\textsuperscript{17}—can be seen as an effort to develop mechanisms to aid the board both in detaching itself from management and in divvying up the board’s key monitoring functions. Moreover, efforts by Congress and the SEC to place additional and different functions on senior officers can be seen as supplementing, rather than displacing, existing state-law-based fiduciary duties of officers.

Recalling the agency law status of corporate officers, however, does more than preserve state law as the cornerstone of governance relationships in our federal system. At a practical level, and this is the second benefit of our thesis, it clarifies immensely why courts can and should scrutinize officer conduct more closely than they now review director performance—i.e., the fiduciary duties of agents are more demanding than those of directors, and officers rightly face a greater risk of personal liability for misconduct. Heightened review of officer performance is especially fitting given that many of the recent corporate scandals involved wrongdoing at the officer level,\textsuperscript{18} and given that state law has been eerily silent about why officers owe duties at all, much less holding them to account. It is also important in light of the fact that recent federal initiatives aimed at improving officer performance eventually will be translated into, and will heavily influence, state fiduciary duty analysis.\textsuperscript{19}

The third payoff of our thesis is several theoretical implications. These include our belief that we are entering an era when, due both to heavier corporate regulation and re-thinking of a shareholder-
centered conception of corporate relationships, \(^2\) the entity conception of the firm will be strengthened. Positive law—including agency law—builds on, and so reinforces, that understanding of corporate relations. This current re-thinking follows a span of perhaps twenty years when a highly “disaggregated” conception of corporate relations—the nexus of contracts theory—has predominated. We also believe that in the policy arguments for and against strong fiduciary duties over the years, virtually no attention has been given to distinguishing whether what is fitting for outside directors in the fiduciary duty area—relatively slack duties—is also fitting for corporate officers. Moreover, although agency law suggests greater liability for officers than directors, widespread and longstanding failure to understand officers in those terms means corporate law cannot as confidently assume that existing liability outcomes for officers are optimal, as might be the case with rules governing directors. \(^2\)

We believe that, from a policy perspective, the fiduciary duties and liability rules for officers should be analyzed separately from those for outside directors. Contemporary corporate law and fiduciary discourse, however, do not do so, thereby hindering attention to this subject. In the terms recently used by Professors Black, Cheffins, and Klausner to describe the state of the law governing “outside” directors, we believe the “window” of liability risk for “inside” directors—i.e., officers—is in fact wide open, even though it is thought, wrongly, to be virtually shut. \(^2\)

After Part I describes and attempts to explain the odd void in both positive law and corporate theory on the distinctive fiduciary status of corporate officers, Part II briefly describes those duties and then addresses at greater length why that status matters to corporate law and theory. We also draw various policy conclusions in that final section and suggest avenues for further inquiry.

\(^2\) See infra notes 232-35 and accompanying text.


\(^2\) See id.
I. CORPORATE OFFICERS AS AGENTS: THE ROLES OF LAW, INSTITUTIONAL REALITY, AND THEORY IN SHAPING DISCOURSE

A. Officers in Corporate Governance

Contemporary debates over corporate governance ills and reforms have, in a rather puzzling way, forgotten some basic distinctions between two critical participants in corporate governance: directors and officers. First, directors, unlike officers, are elected and can be removed by stockholders; officers are appointed and can be removed only by, or under a grant of authority from, directors. Second, neither the board of directors as a body, nor individual directors, are agents of either the stockholders or of the corporation; officers, such as the chief executive officer, the chief

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24. DEL. CODE ANN. tit. 8, § 142 (2001); 2 MODEL Bus. CORP. ACT ANN. § 8.40 (3d ed. Supp. 2000-2002). Technically, under Delaware's corporate statute, officers are to be chosen in the manner "prescribed by the by-laws or determined by the board of directors or other governing body." DEL. CODE ANN. tit. 8, § 142(b). It is possible, though extremely unlikely, that the bylaws of a public corporation could provide for selection of officers by persons other than corporate directors, such as stockholders.

25. This assertion is universally accepted today. See, e.g., Burcham v. Unison Bancorp, Inc., 77 P.3d 130, 147 (Kan. 2003) ("It would be an analytical anomaly ... to treat corporate directors as agents of the corporation when they are acting as fiduciaries of the stockholders ....") (quoting Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 540 (Del. 1996)); RESTATEMENT (SECOND) OF AGENCY § 14C (1958) ("Neither the board of directors nor an individual director of a business is, as such, an agent of the corporation or of its members."); RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(2) (Tentative Draft No. 2, 2001) (noting assertion that directors are not agents); Robert C. Clark, Agency Costs Versus Fiduciary Duties 55, 56, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (John W. Pratt & Richard J. Zeckhauser eds., 1985) ("[D]irectors are not agents of the corporation ... [or] of the stockholders."). Many courts and commentators, however, were describing directors as agents as recently as several decades into the twentieth century. See, e.g., Rudolph E. Uhlman, The Legal Status of Corporate Directors, 19 B.U. L. REV. 12, 12-13 (1939). An excellent early, but initially ignored, decision rejecting characterization of directors as agents is Hoyt v. Thompson's Executor, 19 N.Y. 207 (1859). The court stated: The board of directors of a corporation do [sic] not stand in the same relation to the corporate body which a private agent holds toward his principal.... [I]n corporate bodies, the powers of the board of directors are, in a very important sense, original and undelegated. The stockholders do not confer, nor can they revoke those powers. Id. at 216. Much theoretical work in corporate scholarship, however, continues to conceive of directors as "agents" of shareholders, especially in advocating a "monitoring" model of the board of directors. See Lynn A. Stout, The Shareholder as Ulysses: Some Empirical Evidence
financial officer, general counsel, executive vice presidents, and
many others,26 all are agents of the corporation,27 the principal.
Third, directors are fiduciaries for the corporation and its stockhold-
ers notwithstanding the fact that they are not agents;28 corporate

on Why Investors in Public Corporations Tolerate Board Governance, 152 U. PA. L. REV. 667, 673-77 (2003) (citing scholarship). Professor Stout’s insightful article fleshes out alternative conceptions of the board of directors’ role in corporate governance. We elaborate in this Article a conception of the officers’ role and the nature of officer fiduciary duties.

26. For example, the bylaws of Enron Corporation provide very broadly that its officers shall be

a Chairman of the Board, a President, one or more Vice Presidents (any one or
more of whom may be designated Executive Vice President or Senior Vice
President), a Treasurer, a Secretary, a General Counsel, and such other officers
as the Board of Directors may from time to time elect or appoint (including, but
not limited to, a Vice Chairman of the Board, a Deputy Corporate Secretary, one
or more Assistant Secretaries and one or more Assistant Treasurers).

Bylaws of Enron Corp., art. v, § 1, available at http://contracts.corporate.findlaw.com/agreements/enron/bylaws.1996.02.13.html (last visited Oct. 6, 2004). Such language is typical for public corporations, with the result that there are many officers in most companies. In addition to de jure officers, de facto officers are those persons who actually exercise the duties of an officer without holding formal office, and they too owe fiduciary duties. See, e.g., In re Holiday Isles, Ltd., 29 B.R. 827, 830 (Bankr. S.D. Fla. 1983).

(“Consistent with the principles of agency, which generally govern the conduct of corporate employees, an officer is expected .....”); HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS § 103 (1927) ("The president, treasurer, secretary, manager, cashier, and other officers of a corporation are members [sic] its agents ....”); Langevoort, supra note 11, at 1191 ("Almost every corporate employee with discretionary responsibilities is an agent ...."); see RESTATEMENT (THIRD) OF AGENCY §3.03 cmt. e(1) (Tentative Draft No. 2, 2001) ("Corporate legislation contemplates that the corporation’s directors and in some instances its shareholders have power to and will appoint officers as agents of the corporation."). Unlike the Restatement (Second) of Agency, the Restatement (Third) of Agency—now in draft—will deal with organizational principals as well as individual principals. Despite these many proper descriptions, there are remarkably few cases that acknowledge the agency status of officers in actions brought by the corporation, or a stockholder, against an officer. See, e.g., Shields v. Cape Fox Corp., 42 P.3d 1083, 1091 (Alaska 2002); Potter v. Pohlad, 560 N.W.2d 389, 394 (Minn. Ct. App. 1997) (“We agree that officers, as agents of the corporation, have an obligation to disclose information material to the board’s ability to make an informed decision .....”). There are, however, countless cases involving disputes between corporations and third parties where the agency status of corporate officers is undisputed, although the scope of their authority is hotly contested. See generally Frederick G. Kempin, Jr., The Corporate Officer and the Law of Agency, 44 VA. L. REV. 1273 (1958) (discussing the authority of executive officers).

28. Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (“The directors of Delaware corporations stand in a fiduciary relationship not only to the stockholders but also to the corporation upon whose boards they serve.”); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (“[C]orporate directors have a fiduciary duty to act in the best interest of the corporation’s stockholders.”).
officers are fiduciaries because they are agents. The very definition of "agency" expresses its fiduciary nature, while also capturing the essential idea that the agent must act on behalf of the principal and subject to the principal's control.

That officers are agents, and therefore fiduciaries subject to the control of directors acting on behalf of the corporate principal, can be seen in the basic architecture of governance established by corporate statutes. Simply put, stockholders elect directors who, by statute, exercise, or authorize others to exercise, all corporate powers and manage, or direct others in the management of, the business and affairs of the corporation. The board of directors, in other words, is endowed with plenary governance authority and is the body most centrally responsible for the well-being of the corporate enterprise. Yet, in a public corporation, directors do not—because realistically, they cannot—exercise their statutory prerogative to manage. Instead, the management function is vested by the board in others they appoint—officers—who act under the board's "direction." Acting on behalf of the corporation, the board of directors appoints and sets the compensation of senior officers, delegates managerial responsibilities to those officers, and monitors and evaluates the managerial performance of officers. Officers, though wielding vast delegated power and authority, are agents of the corporation itself, whose interests the board of directors must ultimately protect. As agents, corporate officers owe an array of fiduciary duties. Breach of any of these duties affords the principal

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29. Restatement (Second) of Agency § 1 ("Agency is the fiduciary relation which results from the manifestation of consent by one person [the principal] to another [the agent] that the other shall act on his behalf and subject to his control, and consent by the other so to act."); see Fasciana v. Elec. Data Sys. Corp., 829 A.2d 160, 169 & n.30 (Del. Ch. 2003).

30. Restatement (Second) of Agency § 1.

31. See supra note 23 and accompanying text.

32. Del. Code Ann. tit. 8, § 141(a) (2001) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors ... "); see also 2 Model Bus. Corp. Act Ann. § 8.01(b) (3d ed. Supp. 2000-2002) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors ...").

33. See infra Part II.C. For commentary on the importance of the word "direction" in the corporate statute, see Lyman Johnson, Rethinking Judicial Review of Director Care, 24 Del. J. Corp. L. 787, 808 (1999). Of course, a person may serve both as a director and as an officer of a particular corporation.

34. See infra Part II.A.
a host of remedies, including a tort action for losses caused by the breach. This, in theory, is how officers, in their capacity as agents, fit into the standard model of corporate governance.

Critically, however, although officers, like all agents, are to act on behalf of their principal, it is not their function, nor is it within their fiduciary duty, to monitor their own performance on behalf of the principal. According to basic agency law norms, that function remains the responsibility of the principal itself, whether it is an individual or a complex organization. In the case of an organizational principal, that responsibility necessarily must be discharged by a governing body, such as the business corporation's board of directors or a university's board of trustees. There appears to be a widespread tendency, however, for such governing bodies, after delegating responsibilities to management, to avoid developing structures, systems, and mechanisms to monitor, supervise, and, if need be, control management on an ongoing basis. Too often, delegation of management—necessary and proper—foreshadows the unnecessary and improper relinquishment of the principal's power and duty to control. In a corporation, the responsibility for representing corporate interests in relation to senior officers belongs to the board of directors. Failure to discharge that function is an abdication of the board of directors' statutory responsibility for providing "direction" over the corporation's business and affairs, and it is a breach of the fiduciary duties it owes to the corporation and its stockholders.

35. RESTATEMENT (SECOND) OF AGENCY § 399.
36. See supra note 29 and accompanying text.
37. An officer's governance function and fiduciary duty may, however, require the officer to monitor the performance of a more junior officer. The authors thank Professor Deborah DeMott for emphasizing this point. For example, a CEO should be regarded as having both the governance responsibility to monitor the performance of the chief operating officer (COO) and the fiduciary duty to disclose to the board of directors pertinent information about the COO's faulty conduct. The Enron Bankruptcy Examiner criticized two senior officers of Enron for their failure in this regard. See infra notes 171-72.
38. The nature of an agency relationship is such that the agent consents to be subject to the principal's control, throughout the relationship. RESTATEMENT (SECOND) OF AGENCY §§ 1, 14.
39. See infra notes 78-95 and accompanying text.
Within the field of corporate governance, the undoubted legal status of corporate officers as agents is rarely noted.\(^\text{42}\) The agency status of officers seems to be far more significant to the issue of whether, in a particular case, officers have power to affect the corporation's relationship with third parties than to the issue of the fiduciary duties owed by officers, as agents, to their corporate principal. Although the fiduciary status of corporate officers is widely noted,\(^\text{43}\) two points about the recognition of that status are conspicuous. First, it is only rarely grounded on agency principles.\(^\text{44}\) Second, it is not differentiated from the fiduciary status of directors.\(^\text{45}\) Moreover, in contrast to the countless cases brought against directors, relatively little litigation asserting breach of fiduciary duty claims against officers seems to have been brought either by boards of directors or, derivatively, by shareholders.\(^\text{46}\) This latter phenomenon may be changing, however, as the governance scandals of the late 1990s are leading to the initiation of civil litigation against corporate officers in their specific capacity as officers. Two high-profile examples include the Enron Bankruptcy Examiner's recent conclusion that Enron's senior officers breached fiduciary duties,\(^\text{47}\) and the Kmart Creditor Trust's litigation against former officers for breach of fiduciary duty.\(^\text{48}\)

Historically, however, for the most part, officers appear not to be sued for fiduciary wrongdoing as officers. Addressing Delaware law, a leading corporate law treatise summarily states: "few authorities deal with the nature of the obligation owed by officers

\(^{42}\) See infra notes 56, 189 and accompanying text.

\(^{43}\) See supra note 10 and accompanying text.

\(^{44}\) See infra notes 56, 189 and accompanying text.

\(^{45}\) See infra note 10 and accompanying text; infra notes 54-55 and accompanying text.

\(^{46}\) A leading treatise on corporate directors and officers summed up the state of the law as follows: "[T]here is little law on the subject of the liability of corporate officers who are not directors." WILLIAM E. KNEPPER & DAN A. BAILEY, 1 LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.15, at 1-53 (7th ed. 2003).

\(^{47}\) Third Interim Report of Neal Batson, Court-Appointed Examiner, In re Enron Corp., No. 01-16034 (AJG) (Bankr. S.D.N.Y. June 30, 2003), http://news.corporate.findlaw.com/hdocs/docx/enron/enronbk72803x3.pdf. As noted below, the Examiner conflates officer and director duties, as is the unfortunate norm in fiduciary discourse. See infra notes 54-55 and accompanying text.

to the corporation and its stockholders. The foundational duty of loyalty case in Delaware, moreover, groups officers and directors together when discussing fiduciary obligations, neither distinguishing the differing roles of directors and officers in corporate governance nor articulating any theoretical bases for imposing a single conception of fiduciary duties on officers as well as directors. This approach appears predominant in commentary and case law. Other case law, however, ignores the issue altogether, offering no explicit basis for imposing officer fiduciary duties. In the most high profile corporate case today—Enron—the Bankruptcy Examiner concluded: "As a general matter, corporate officers owe the same fiduciary duties to the corporation as do corporate directors."

49. R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, 1 THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.17, at 4-36 (3d ed. Supp. 2003); see A. Gilchrist Sparks III & Lawrence A. Hamermesh, Common Law Duties of Non-Director Corporate Officers, 48 BUS. LAW. 215, 215 (1992) ("The precise nature of the duties and liabilities of corporate officers who are not directors is a topic that has received little attention from courts and commentators.").

50. See Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

51. The Delaware Supreme Court, however, has properly applied agency principles as the legal basis for imposing duties on non-officer employees. See Science Accessories Corp. v. Summagraphics Corp., 425 A.2d 957 (Del. 1980). In doing so, the court stated: "The[ ] principles and limitations of agency law carry over into the field of corporate employment so as to apply not only to officers and directors but also to key managerial personnel." Id. at 962. The statement about directors being agents is wrong. See supra note 25 and accompanying text. The court’s correct statement about officers being agents has never been cited by a Delaware court for that proposition. It was, however, cited by the Minnesota Court of Appeals in a decision applying Delaware law. See Potter v. Pohlad, 560 N.W.2d 389, 394 (Minn. Ct. App. 1997); see also Lazard Debt Recovery GP, LLC v. Weinstock, C.A. No. 19503, 2004 WL 1813286, at *8 (Del. Ch. Aug. 6, 2004) (citing agency principles in litigation involving partnerhsip); In re eBay Inc. S’holders Litig., No. C.A. 19988-NC, 2004 WL 253521, at *5 (Del. Ch. Feb. 11, 2004) (noting common law duty of agent).

52. See supra note 10 and accompanying text; infra notes 54-55 and accompanying text.

53. An example is Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146 (Me. 1995), now a leading case on the subject of corporate opportunity. The case involved a claim that a corporation’s president had usurped corporate opportunities. Id. at 1148. The Supreme Court of Maine began its legal analysis by asserting that "[c]orporate officers and directors bear a duty of loyalty to the corporations they serve." Id. Thereafter, the court referred to "corporate fiduciaries" and described the president as a "fiduciary" without stating why a corporate president occupies that status. See id. at 1148-49.

Commenting on the corporate law applicable to Enron—the law of Oregon—the Examiner noted that "Oregon courts have referred to the fiduciary duties of officers and directors interchangeably." In short, although officers and directors occupy distinctive roles in corporate governance, most corporate law authority uncritically obliterates that distinction when it comes to fiduciary duties.

B. Forgetting Why Officers Are Fiduciaries

There may be several reasons for the striking dearth of attention to the distinctive status of corporate officers as fiduciaries. First, boards of directors may deal with officer misconduct by contractual means. That is, boards may negotiate settlements with officers as part of an intracorporate sanction, whether that sanction be discharge, reprimand, compensation adjustment, demotion, or delayed promotion. Given that the majority of officers leaving office due to violations of corporate ethics and compliance codes receive severance packages, it is likely as well that this resolution entails the release of all claims, whatever the underlying legal theory of

55. Id.
56. This is not to say that there are no decisions holding officers liable for breach of fiduciary duty. There are several, though far fewer than one might expect. See Sparks & Hamermesh, supra note 49 (collecting cases); see also Knepper & Bailey, supra note 46, § 1.15. What is puzzling is the dearth of decisional law squarely grounding liability on agency law or acknowledging that it is the officer's status as an agent that carries with it—for sound economic and policy reasons—strong fiduciary duties. See Harry G. Henn & John R. Alexander, Laws of Corporations and Other Business Enterprises § 219, at 586 (3d ed. 1983) (stating that "officers ... are agents of the corporation, and, as such, subject to the usual principles of agency law, including the fiduciary duties of agents," but citing no decisions). The lack of conceptual clarity as to the rationale for officer liability was true in Justice Holmes's famous 1920 opinion holding a bank president liable for mismanagement, Bates v. Dresser, 251 U.S. 524 (1919), and remains true in 2005, as seen by a recent federal court decision holding a chief executive officer personally liable for losses associated with putting his daughter on the corporate payroll and allowing her to use corporate property. See Pereira v. Cogan, 294 B.R. 449, 539 (S.D.N.Y. 2003). These cases are rightly decided, and the Bates case is rich in facts supporting liability, the Court noting the president's "responsibility, as executive officer ... and knowledge, from long daily presence in the bank," 251 U.S. at 530, but both lack a clearly articulated theoretical and doctrinal underpinning.
57. The Conference Board, a New York business research group, conducted a poll of fifty employers and found that 62% of respondents gave a financial package to executives who left because of major violations of ethics and compliance codes. Joann S. Lublin, Windfalls Are Common in Ousters over Alleged Ethics Violations, WALL ST. J., Nov. 25, 2003, at B8.
liability. Consequently, reported decisions involving officers would be infrequent.

Second, lawyers for shareholders, and perhaps also for boards of directors, and even judges, simply may not appreciate the distinctive fiduciary obligations owed by officers to the corporation as agents, obligations existing in addition to those created expressly by contract. Although it is standard practice for corporate counsel to advise directors of their fiduciary duties, it seems doubtful that officers (or directors) are routinely advised by legal counsel that officers owe duties in their capacity as officers.

Third, lawyers may not fully appreciate the fiduciary duties of agents in the corporate context because law schools today appear to devote significantly less time and attention to agency law principles than they did, say, thirty or forty years ago. Fourth, until the 1980s, most boards had a majority of "inside" directors—i.e., directors who were also employed by the company. These senior officers, accordingly, already had fiduciary duties in their capacity as directors. Understandably, this may have led lawyers, courts, and commentators to overlook the distinctive duties owed as officers, and to group officers and directors together as "corporate fiduciaries."

Fifth, until January 1, 2004, the Delaware Chancery Court did not have personal jurisdiction over officers as such. Accordingly, legal action against officers who were not also directors could not—absent other jurisdictional means—be brought in the Chancery Court. In recent law review articles, Chancellor Chandler and Vice Chancellor Strine, and, separately, Professor Hillary Sale, argue that Delaware's lack of personal jurisdiction might be the reason no claims have been made against officers. Before a claim can be

58. See infra Part II.A (specifying fiduciary duties of officers).
60. See, e.g., supra notes 50, 54-55 and accompanying text.
brought, however, a theoretical and doctrinal rationale for it must exist. The causal direction, therefore, possibly runs the other way, and the reason Delaware did not assert jurisdiction over officers may be that no one considered officers to occupy a fiduciary status distinct from that of directors. Now that jurisdiction does exist in Delaware, agency law provides the legal rationale for imposing fiduciary duties on corporate officers and can provide the theory supporting monetary claims by the corporation based on officer misconduct.

Finally, the overly “cozy” relationship between boards of directors and senior officers that has been the subject of much recent criticism may result in a corporate culture in which directors do not regard officers as persons owing high fiduciary duties to the corporation. Instead, they may feel indebted to the officer or believe it is their responsibility to support senior officers. Indeed, they may still regard those officers, especially a chief executive officer, as “the boss” and therefore akin to the principal, rather

63. See, e.g., Robert B. Thompson & Hillary A. Sale, Securities Fraud as Corporate Governance: Reflections upon Federalism, 56 VAND. L. REV. 859, 905 (2003) (describing the “hole in Delaware law brought about by the lack of liability for, and concomitant inability to sustain, suits for breaches of the [officer] fiduciary duty of care”).

64. Former Chief Justice Veasey of the Delaware Supreme Court recently described as a “likely development” a “new focus on litigation going after officers,” but he specified “fraud” rather than violation of fiduciary duties as the expected theory in such cases. E. Norman Veasey, Corporate Governance and Ethics in the Post-Enron WorldCom Environment, 38 WAKE FOREST L. REV. 839, 851 (2003).

65. SEC Commissioner Cynthia Glassman, speaking to the National Association of Corporate Directors on October 20, 2003, addressed what she called the “closed nomination process dominated by powerful CEOs, and the entrenchment of directors, [which] led to an unhealthy coziness in some instances between ostensibly independent directors and the executives whose performance they were supposed to oversee.” Proposed Proxy Access for Shareholders May Go Too Far, SEC’s Glassman Tells NACD, 35 Sec. Reg. & L. Rep. (BNA), No. 43, at 1814 (Nov. 3, 2003); see also Chandler & Strine, supra note 62, at 967 (describing recent reforms as seeking to “cleanse the independent director ranks of corporate America of persons whose familial, personal, professional, or financial affiliations with management cast doubt on their ability to pursue only the interests of the company’s stockholders”).

66. SEC Chairman William Donaldson described the problem as follows: Over the past decade or more, at too many companies, the chief executive position has steadily increased in power and influence. In some cases, the CEO had become more of a monarch than a manager. Many boards have become gradually more deferential to the opinions, judgments and decisions of the CEO and senior management team. This deference has been an obstacle to directors’ ability to satisfy the responsibility that the owners—the shareholders—have delegated and entrusted to them.
than, as is the case legally, an agent owing fiduciary responsibility to the corporation, whose institutional interests the directors are under their own distinct fiduciary duty to protect.67

The last point warrants elaboration because it reflects a pervasive and longstanding problem in corporate governance. Corporate statutes clearly ordain a governance arrangement contemplating that directors, not officers, will play the central role in corporate governance.68 There long has been a widespread belief, nonetheless, that, in fact, officers wield greater influence in corporate affairs than do directors.69 This stunning, de facto "reversal of

SEC Chairman William H. Donaldson, Remarks at the 2003 Washington Economic Policy Conference, National Association for Business Economics (Mar. 24, 2003), at http://www.sec.gov/news/speech/spch032403whd.htm. As Professor Daniel Kleinberger puts it, "the agent may be the 'star' and the principal merely the supporting context. Consider, for example, Itzhak Perlman serving for a season as first violinist of a metropolitan orchestra or Barry Bonds playing baseball for the San Francisco Giants." DANIEL S. KLEINBERGER, AGENCY, PARTNERSHIPS, AND LLCs: EXAMPLEs AND EXPLANATIONS 117 n.2 (2d ed. 2002). As SEC Chairman Donaldson noted, to those names could be added the names of many high-profile, forceful corporate CEOs.

67. Vice Chancellor Strine, addressing a related legal issue, recently described more generally how the social dynamic for corporate directors may inhibit them from fully discharging their responsibilities:

Nor should our law ignore the social nature of humans. To be direct, corporate directors are generally the sort of people deeply enmeshed in social institutions. Such institutions have norms, expectations that, explicitly and implicitly, influence and channel the behavior of those who participate in their operation. Some things are "just not done," or only at a cost, which might not be so severe as a loss of position, but may involve a loss of standing in the institution. In being appropriately sensitive to this factor, our law also cannot assume—absent some proof of the point—that corporate directors are, as a general matter, persons of unusual social bravery, who operate heedless to the inhibitions that social norms generate for ordinary folk.

In re Oracle Corp. Derivative Litig., 824 A.2d 917, 938 (Del. Ch. 2003).

68. See supra note 32 and accompanying text.

69. Perhaps the most famous study in support of this position is that published in 1971 by Professor Myles Mace. MYLES L. MACE, DIRECTORS: MYTH AND REALITY 72-85, 190-94 (1971); see also Myles L. Mace, The President and the Board of Directors, 50 HARV. BUS. REV., Mar.-Apr. 1972, at 37 (describing how directors actually interact with corporate presidents). This remains a widely shared view. See supra notes 65-67; infra text accompanying notes 93-95. Although a later study by Professors Jay Lorsch and Elizabeth Maclver found that boards of directors played a more central governance role in the late 1980s than Professor Mace had found, see JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 75-96 (1989), that finding does not necessarily mean that senior officers do not still hold substantial influence over corporate management. See Robert W. Hamilton, Corporate Governance in America 1950-2000: Major Changes but Uncertain Benefits, 25 J. CORP. L. 349, 363-64 (2000).
control,” to use sociologist Harrison White’s phrase, is the key animating force in recent congressional, SEC, NYSE, and Nasdaq governance reforms. In various ways, the regulatory initiatives of these bodies seek to rectify this deep-rooted problem of “role reversal” in the state law-created system of corporate governance. Congress and the SEC, through the Sarbanes-Oxley Act, sought to meliorate the perceived imbalance of power by directly imposing new federal responsibilities on corporate officers. Those bodies, joined by the NYSE and Nasdaq, also substantially bolstered the obligations of directors.

Current federal reforms aim directly to fix a longstanding reversal of control problem made possible not because of defects unique to the basic architecture of corporate governance, but rather due to problems inherent in the dynamics of principal-agent relationships in all complex organizations, including, as Professor White notes, corporations and churches. Reversal of control in principal-agent relationships was observed by Karl Llewellyn as long ago as 1930. In words worth remembering by those who work in corporate governance, Llewellyn first noted the central importance of agency principles in business enterprises by pointing out that agency “remains the major building material, even in the corporate structure.” He then identified how “with growing specialization, agency takes on another aspect ... [as] the specialized purveyor ... moves largely out of the control of his principal, [and] becomes an independent unit ... [who] may gather sufficient financial power to finance and even control his scattered 'princi-

71. See supra note 6.
72. See supra note 7.
73. See supra note 8.
74. See supra note 9.
75. See supra note 6 and accompanying text. For a detailed discussion of these responsibilities, see Johnson & Sides, supra note 6.
76. See supra notes 8-9.
77. See supra notes 6-7.
78. See White, supra note 70, at 205-08.
80. Id.
In other words, the agent, not the principal, wields control. Professor White considers this insidious tendency to be the key "conundrum" of agency relationship. The reversal of control can be so deep-seated in an organization that it ironically threatens to undermine the "root" purpose of agency, that is, to deploy the agent to enlarge the realm of the principal's control.

Llewellyn's and White's generic description of control reversal in principal-agent relationships nicely captures the dynamic between corporate directors and officers, a dynamic first criticized prominently in the early 1970s. The gist of the governance critique was that the director-centered statutory model of corporate relationships was more myth than reality. This analysis of the director-officer interface was greatly substantiated by Professor Myles Mace's devastating empirical findings on director activities. It complemented the critique—levelled forty years earlier by Berle and Means—that, in shareholder-director interaction, directors, rather than shareholders, exercised control.

The reversal of control in corporate governance from the principal—the corporation, as represented by the board of directors—to the agent—the chief executive officer and other senior officers—was manifested in several ways by the early 1970s. First, rather than directors selecting the chief executive officer (CEO), the CEO often handpicked candidates for the board, many of whom, in those days, also worked for the company and, as such, were beholden to the CEO. Second, the CEO, rather than the board, usually selected a successor CEO. Third, the board generally "[did] not establish [corporate] objectives, strategies, and policies"; rather, this was done by the CEO. Fourth, the board rarely asked discerning questions

81. Id.
82. See White, supra note 70, at 208.
83. Id.; see supra text accompanying note 30.
84. See supra note 69 and accompanying text.
85. See MACE, supra note 69, at 72-85, 190-94 (describing the reality of corporate directors failing to hold the president to account).
87. See Barry Baysinger & Robert E. Hoskisson, The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy, ACAD. MGMT. REV. 72, 72-73 (1990); Mace, supra note 69, at 40, 43.
88. Mace, supra note 69, at 43.
89. Id. at 41.
Finally, the board’s key roles shrank to offering advice and counsel to the CEO, serving as discipline for the CEO through the ritual of the CEO making regular reports to the board and acting as a decision-making body only in crisis. Moreover, when that crisis involved declining enterprise profitability, directors tended to procrastinate and avoid taking corrective action, preferring instead simply to hope the situation would somehow improve.

C. Officer Control Subdues the Legal Model

This officer-centered pattern of corporate power is a long way from the legal model, according to which the board exercises control over corporate affairs. As expressed by former Supreme Court Justice Arthur Goldberg, writing in 1972, a modern board of directors has been “relegated to an advisory and legitimizing function that is substantially different from the role of policy maker and guardian of shareholder and public interest contemplated by the law of corporations.” Professor Alfred Conard, writing in 1976, put it more sharply: “[Directors] do not supervise and control the executives; rather, they are supervised and controlled by the executives.” Federal Reserve Chairman Alan Greenspan noted in 2002 that the problem continues: “Our vast and highly liquid financial markets enable large institutional shareholders to sell their shares when they perceive inadequacies of corporate governance, rather than fix them. This has placed de facto control in the hands of the chief executive officer.”

One salient manifestation of control reversal is the widespread United States practice of the CEO also serving as chair of the board of directors. Under this peculiar arrangement, the chief agent to be monitored also serves as the most influential person in the body designed to monitor that agent. An agency law conception of the
board-officer relationship cogently highlights how bewildering and unhealthy this practice really is.96

Several underlying reasons for the systemic reversal of control in corporate governance have been identified. Professor Conard has noted the inherent structural obstacles to directors being involved more deeply in management.97 Directors do not sit continuously in director capacity, nor, generally, do they make decisions promptly.98 Professor Melvin Eisenberg summarizes the practical constraints on directors exercising a more meaningful managerial role in corporate governance as being those of limited time, limited information, and a composition of members with interests that predispose them to acquiesce to officer desires.99

From a deeper, sociological vantage point, Professor White argues that this reversal of institutional power results because agency relationships within complex organizations encourage specialization of two kinds.100 The first is "specialization in analytical skills, whether through practice or training,"101 and the other is "specialization by localization,"102 that is, the outcome of "accumulating familiarity with the details of local situations."103 Applying this observation to the corporate milieu, it can readily be seen that corporate officers not only gain important managerial expertise throughout the trajectory of their careers, but, for those who rise within the company, they also acquire firm-specific familiarity with the details of the particular companies they manage as they gain "promotion through the thicket of subexecutives, managers and superintendents."104 This "local knowledge," and the dense intracorporate network of relationships built up over many years, cannot

96. See infra Part III.C.3.
97. See CONARD, supra note 94, at 349.
98. Id.
99. MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 203-04 (8th ed. 2000). Professor White, however, believes it is "misleading" to focus on information [as]ymmetries as an explanation for the reversal of control problem. He believes that "[a]symmetry in information is better thought of as a by-product and an implication of asymmetry in control, rather than the cause of problems in control." White, supra note 70, at 204.
100. White, supra note 70, at 204-05.
101. Id. at 205.
102. Id.
103. Id.
104. CONARD, supra note 94, at 353.
be matched by directors meeting only several times a year, averaging a mere 40 hours per year on director functions in the 1970s, and in 2002, still spending only about 190 hours annually on director duties.105

Reversal of control in principal-agent relationships, especially those involving complex organizations, can eventually become so pronounced that it "interfere[s] with the achievement of the purposes for which the agency relationship was originally created."106 Again, applying this insight in the corporate setting, we saw in the 1990s how immediate enrichment of executive officers through stock options often came to supplant sustained corporate and stockholder welfare as the paramount concern of too many corporate officers.107 In agency terms, they did not always act on behalf of the corporation.108 This emphasis on personal welfare over institutional well-being may reflect an inevitable progression of control reversal, as operational control—rightly in the hands of agents—evolves into the realm of strategic control and control over the very goals of a venture, and agents become ever more prominent as the principal correspondingly recedes from view.109 Taking this dysfunctional dynamic to its logical conclusion, perhaps we can see why the chief


106. White, supra note 70, at 205.

107. The Financial Economists Roundtable recently issued a report concluding that widespread use of stock options to compensate senior officers "may have created incentives for managers to manipulate company financial statements in order to drive up stock prices, contributing to the recent corporate scandals." Statement, Financial Economists Roundtable, The Controversy over Executive Compensation (Nov. 24, 2003), at http://www.luc.edu/orgs/finroundtable/statement03.pdf. SEC Commissioner Cynthia Glassman also has expressed concern about this problem: "[I]t should be clear from the recent scandals that there is a risk that some executives will manage to short-term performance goals to maximize their compensation." SEC Commissioner Cynthia A. Glassman, Private and Public Sector Response to Corporate Governance Issues, Comments Before the Conference on Bank Structure and Competition (May 9, 2003), at http://www.sec.gov/news/speech/spch050903cag.htm. See generally LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY (2001) (proposing that short-term stock price maximization endangers the economic well-being of American society); David Millon, *Why Is Corporate Management Obsessed with Quarterly Earnings and What Should Be Done About It?*, 70 GEO. WASH. L. REv. 890 (2002) (noting that managerial shortsightedness may sacrifice potentially more lucrative opportunities that yield returns only over the long-term).

108. See supra text accompanying note 30.

109. See White, supra note 70, at 205.
executive officer, undoubtedly an agent in law, no longer is thought of, or described in, those terms either within corporate governance or in the larger corporate and business culture. Rather, when the transformation of control is complete, it is no wonder that the nomenclature of agency is so undeveloped in describing the status of officers in corporate governance—it does not seem to reflect reality. Instead, it can confidently and ironically be said that “[t]he CEO is the principal, in effect.”

D. Fiduciary Discourse Accommodates Reality

The striking dichotomy between the legal model of the director-officer relationship, on the one hand, and institutional reality, on the other hand, contributed to the non-development of agency discourse for describing the fiduciary status of corporate officers. As director and officer roles blurred, or even reversed, conceptions of officer fiduciary status quite rapidly achieved the *sui generis* status only gradually achieved by directors. Throughout the late nineteenth century and well into the twentieth century, the fiduciary status of directors was conceptualized in a variety of bewildering ways in an effort to conform to preexisting legal categories. Directors were described variously as “mandatories,” “bailees,” and “trustees,” as well as “agents.” None of these legal classifications fit. Eventually, as noted by Rudolph Uhlman, writing in 1939, many courts and commentators ended their futile taxonomic efforts and simply emphasized “the fiduciary character of the directors’ office, instead of compressing it into one of the conventional classifications.”

Uhlman, presciently anticipating how settled twentieth century law would eventually treat directors, concluded that “the description of a director as a fiduciary is as fair

110. John W. Pratt & Richard J. Zeckhauser, *Principals and Agents: An Overview*, in *PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS* 1, 33 (John W. Pratt & Richard J. Zeckhauser eds., 1985). SEC Chairman William H. Donaldson put the matter somewhat less benignly in stating that too often CEOs have become “more of a monarch than a manager.” Donaldson, *supra* note 66; see also A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (noting that the “claims upon the assembled industrial wealth and funneled industrial income which managements are then likely to enforce (they have no need to urge) are their own”).


112. *Id.* at 16.
a characterization of his position as may be made under the circumstances.”

As officers achieved greater hegemony in corporate governance throughout the twentieth century, legally they could still properly be classified as “agents”—unlike directors—and their fiduciary duties could sensibly and easily be grounded on their agency status. That description, however, wrongly suggested they were under the control of the board. Functionally, they were not. Moreover, until the early 1970s, most corporate statutes provided that boards of directors actually were to “manage” the corporation. Directors, therefore, were legally considered managers, although, in fact, senior officers performed much of that function. Legal form eventually yielded to institutional reality for directors, as corporate statutes were amended to provide that the management function need only be under the board’s “direction.” For officers, their formal legal status as agents continued “on the books” but withered, as a point of emphasis, in the face of reality.

Furthermore, beginning at least with Berle and Means’s landmark book published in 1932, it has been quite common in corporate discourse to include both directors and officers within the non-legal term “managers.” Berle and Means occasionally differentiate

113. Id. at 16-17.
114. See supra note 27 and accompanying text. Even in 1891, the United States Supreme Court, although confused on the legal status of corporate directors, rightly described officers as “agents of the corporation.” Briggs v. Spaulding, 141 U.S. 132, 147 (1891).
115. See supra text accompanying note 30.
116. Section 8.01(b) of the Model Business Corporation Act was amended in 1974 to provide what is essentially its current language, which reads that the corporation shall be managed “under the direction of” the board. 2 MODEL BUS. CORP. ACT ANN. § 8.01 historical background at 8-8 (3d ed. Supp. 2000-2002). Prior to that, it had provided that the business and affairs of the corporation would be “managed by” the board of directors. Id. The wording was amended out of a concern that the prior language “could be interpreted to mean that directors must become involved in the detailed administration of the corporation’s affairs.” Id. In sections 3.01 and 3.02, the American Law Institute’s Principles of Corporate Governance, adopted in 1992, seek more sharply yet to differentiate the functions of senior executives, who are responsible for “management,” from the functions of directors, who do not “manage.” AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §§ 3.01-3.02 (1992).
117. See supra note 32.
118. See BERLE & MEANS, supra note 86; see also ROBERT CHARLES CLARK, CORPORATE LAW 23-24 (1986) (describing “centralized management”). Even as early as 1877, George W. Field’s treatise on corporation law noted that corporations usually conferred management authority “upon a limited number of the members usually called directors or managers, who act, in most
between directors and officers, but more often use the term "managers" or "management." They state, for example, that "managers consist of a board of directors and the senior officers of the corporation." In this description, they were faithful to the then-prevailing legal model of corporate governance, which provided that directors also "managed" the corporation's business. Functionally, however, Berle and Means described "management" as those who have "formally assumed the duties of exercising domination over the corporate business and assets." That comes far closer to a description of senior officers only, and not directors.

When, as was the case prior to the 1980s, most directors of public corporations were also officers, such imprecision of expression may have been understandable and of no great import. Once a majority of directors were not officers, however, and once corporate statutes were altered to negate the suggestion that directors also "manage," the term "managers" became profoundly inaccurate for directors. Using the same term for two different bodies within corporate governance dangerously suggests a "co-managing" relationship, and such widespread usage may have further contributed to a dulling of the idea that officers are subordinate to the board. In fiduciary duty discourse, courts and commentators, perhaps having in mind the functional rather than the legal status of officers, may pragmatically have concluded, to paraphrase Uhlman's description of directors, that "the description of ... [an officer] as a fiduciary is as fair a characterization of his position as may be made under the circumstances." The result is that the distinctive agency rationale for imposing fiduciary duties on officers largely disappears from corporate law. In its place, officers and directors are routinely lumped together as owing equivalent "fiduciary duties." In conventional fiduciary discourse, consequently, any sense that officers are specifically accountable to the board, rather than together with it, is lost.

respects ... as agents for and in place of the corporation, and of the stockholders." Morton J. Horwitz, Santa Clara Revisited: The Development of Corporate Theory, 88 W. VA. L. REV. 173, 215 (1985) (quoting GEORGE W. FIELD, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS (1877)).

119. BERLE & MEANS, supra note 86, at 196.
120. Id.; see also Berle, supra note 110, at 1366-67 (describing corporate managers).
121. See Uhlman, supra note 25, at 16-17.
122. See supra notes 10, 49-55 and accompanying text.
E. Corporate Theory Blurs Fiduciary Duties

The most important intellectual development in corporate law in the last twenty years or so—the use of economic analysis—introduced a particular conception of corporate relationships that exacerbated the conflation of directors and officers in fiduciary discourse. Drawing on the insights of financial economists who conceive the business firm as a nexus of contracts, many corporate law scholars recast the core accountability concern in corporate governance into a principal-agent “agency costs” issue. The nexus of contracts theory disaggregated the corporation into a series of contractual relations. These relations were not literal, legal contracts, but reciprocal exchange relationships. One key relationship—the one that corporate governance focuses on—is the stockholder-manager relationship. Ironically, this relationship is conceived of as a “principal-agent” relationship, although by too-


126. Melvin A. Eisenberg, The Conception that the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm, 24 J. CORP. L. 819, 822 (1998); see Clark, supra note 25, at 60-62.

127. Black, supra note 124, at 850 (“On the corporate manager side, what incentives do corporate managers have to act as faithful agents of investors[?]”). More traditional neoclassical economists, as well as financial economists, also occasionally described corporate officers as “agents” of stockholders. See, e.g., Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, N.Y. Times, Sept. 13, 1970, § 6 (Magazine), at 32 (“[A] corporate executive is an employee of the owners of the business. He has direct responsibility to his employers.”). When economists describe a principal-agent relationship they mean, generally, any relationship where one person or organization acts on behalf of another. See Paul Milgrom & John Roberts, Economics, Organization and Management 170, 214 (1992). Thus, both directors and officers are “agents” in this account. This economic theory of agency is not the same as the legal concept of agency. Brian R. Cheffins, Company Law: Theory, Structure and Operation 45 (1997). This disjunction between discourses, coupled with the fact that corporate law theory does not comport with positive law treatment of intra-
readily collapsing any meaningful distinction between directors and officers, through conceiving both as "agents" in relation to stockholders, the nexus conception in fact draws attention away from the only true agency relationship in corporate governance: the corporation-officer relationship. It does so in several ways.

First, by disaggregating the firm into a set of reciprocal relationships, the corporation itself becomes an ethereal "nexus," a status equivalent to nonexistence.\(^{128}\) No one denies the juridical fact that, in positive law, corporations are considered legal "persons."\(^{129}\) Yet, in the nexus of contracts conception of relationships, the "corporation" is less significant than the stockholder who, as the residual claimant on firm assets and cash flow, and bearing substantial risk, is recast as the "principal." Oddly, this theoretical move restores stockholders to the place of primacy they enjoyed in corporate law in the mid-nineteenth century, before the strong governance role of the board of directors was clearly differentiated and established. For example, leading corporate law treatise writers stated in 1871 that "[t]he power to appoint officers and agents rests, of course, like every other power, in the body of the corporators [i.e., stockholders]."\(^{130}\) Another treatise writer stated in 1877 that, absent other provision, the power to manage corporate affairs belonged to the stockholders.\(^ {131}\) This nineteenth century conception of stockholders as principals, however, necessarily gave way as the older view that directors were agents yielded to the modern view that director power was original and undelegated.\(^ {132}\) The modern "nexus of contracts" and "principal-agent" theorists conceptually resurrect the

corporate relations, has created confusion in the fiduciary area.


130. Horwitz, supra note 118, at 215 (quoting JOSEPH K. ANGELL & SAMUEL AMES, TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE 257 (9th ed. 1871)). Professor Morton Horwitz points out that the 1861 edition of Angell and Ames's treatise did not have a separate chapter on directors but treated directors in a chapter called "Agents of Corporations," which lumped officers and directors together. Id.

131. Horwitz, supra note 118, at 215 (discussing FIELD, supra note 118); see also Union Pac. R.R. v. Chicago R.R., 163 U.S. 564, 596 (1896) ("[W]hen the charter was silent, the ultimate determination of the management of the corporate affairs rests with its stockholders....").

132. See supra notes 25, 111-13 and accompanying text.
older view of stockholders as principals, thereby demeaning the board as the key actor on behalf of the corporate principal in relation to officer-agents.

Second, having eliminated the "corporation" as "principal"—after all, a "nexus" cannot be a "principal"—it remained for contractarian theorists to identify the "agent." Would it be the board of directors or the senior officers or both? Corporate statutes and case law (by the 1970s) clearly established that directors of public corporations were not expected to manage the corporation's business and were not agents. Officers, as noted before, are agents of the corporation in positive law, but the corporation was effaced in the contractarian theory of the firm, awkwardly leaving officers as agents of stockholders. Perhaps to soften the pointed clash between this theoretical account of officers and their role in positive law, in the contractarian view, the "agents" of the stockholders became the "managers," a more ambiguous concept. "Managers" were, and are, routinely described to include directors and officers, often with little or no distinction being made between them. Lost again is the notion that, although directors and officers are similar in that they each ultimately act to further corporate and stockholders interests—and hence both frequently are referred to as "agents" in finance literature—they differ in a critical way: officers are accountable to directors. In relation to officers, directors are better understood as acting on behalf of the principal, not as agents. Agency law discourse with respect to an organizational principal should not,

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133. As to the nineteenth century view of stockholders as principals, Berle and Means, writing in 1932, stated that in this view:

The management of the corporation indeed was thought of as a set of agents running a business for a set of owners; and while they could and did have wider powers than most agents, they were strictly accountable and were in a position to be governed in all matters of general policy by their owners.

BERLE & MEANS, supra note 86, at 125-26.

134. See supra notes 25, 116-17 and accompanying text. The board thus legally emerged as a governance body distinct from both stockholders, on the one hand, and executive officers, on the other hand, only in the late nineteenth and early twentieth centuries, promptly to recede from a central managerial role in corporate governance throughout the twentieth century.

135. See supra note 27 and accompanying text.

136. See supra note 118 and accompanying text; infra note 142 and accompanying text.

137. See Stout, supra note 25, at 672-73, 689-90 (noting widespread description of directors as "agents" in corporate law scholarship).
either in theory or doctrine, frame the responsibilities or duties of
the principal's representative (the directors) in the same terms as
the duties of the agent (officers). Agency law does not. Agency law
concepts and terminology preserve and illuminate the critical
director-officer interaction attribute of corporate governance;
conventional fiduciary duty discourse within corporate law, recently
aided by the new economic theory of the firm, obscures it.

It is not the aim of this Article to assess the virtues and vices of
the financial economists' theory of corporate relationships.138
Professor Robert Clark rather early on pointed out that it does not
accurately portray positive law.139 Professor Melvin Eisenberg,140
among others,141 notes that although the theory offers one way
to understand the voluntary elements of corporate interaction,
corporations can be conceived in other ways as well; for example,
they also operate by non-bargained-for bureaucratic rules and
hierarchical relations. The point here is that this important
theoretical understanding of corporateness, although using the
analytical rhetoric of agency, ironically served to mask the distinc-
tive agency role of corporate officers when it grouped them with
directors as "managers,"142 the latter term being foreign to positive
law discourse on corporate governance. The new corporate theory
did not originate the practice of grouping directors and officers

138. One point will be noted, however. Contractarians understand corporate law as a set
of mechanisms for reducing agency costs, these being the costs incurred by stockholders to
reduce shirking and self-dealing by agents. See BAINBRIDGE, supra note 124, at 207 n.25.
Implicit in this view is the notion that stockholders have the power, subject only to cost
considerations, to discipline agents in various ways. Yet, the reversal of control critique,
described earlier, see supra text accompanying notes 78-92, operates at a deeper level and
challenges whether, in fact, a principal can control a specialized agent, especially, although
not exclusively, an agent in a complex organization. Little in corporate law today suggests
stockholders wield either the legal or the functional power to discipline (or alter) corporate
officers and their decisions.

139. See Clark, supra note 25, at 59-62; see also CHEFFINS, supra note 127, at 45 ("The
economic theory of agency costs must be distinguished from the legal concept of agency.").
140. See Eisenberg, supra note 126, at 820.
141. See Bratton, supra note 128, at 1501, 1515; Johnson, supra note 125, at 2219-21.
142. Professors Milgrom and Roberts, for example, group officers and directors together
when describing liability. See MILGROM & ROBERTS, supra note 127, at 279. The seminal
article by Jensen and Meckling, see supra note 123, also uses the term "managers" without
differentiating officers and directors. This appears to be the norm among financial economists.
Corporate law scholarship appears to follow that convention widely. Although directors, in
much of that scholarship, functionally are considered "agents" of shareholders in relation to
officers, the functional differences are not developed for fiduciary purposes.
together for purposes of fiduciary duty discourse, but it did—especially among scholars—exacerbate that practice and enhance its legitimacy.

Overall, then, neither older or modern legal theory, nor older or modern positive law in the fiduciary area, has done much to preserve, much less highlight, the agency status of officers. Is this just an interesting, if not odd, story of legal history, or does it represent a significant loss? How does revisiting this issue in 2005 enhance corporate governance or shed light on contemporary issues in corporate law? Part II takes up these questions.

II. AGENCY STATUS AND WHY IT MATTERS

Two responses to the dichotomy between the neglected legal status and the functional reality of corporate officers are possible. The legal status of officers as agents of the corporation might be admitted, but regarded as a technical point only, one carrying no promise for the larger project of restoring directors to a more powerful position in relation to corporate officers. The other response is to regard the agency status of officers as a promising positive law foothold for advancing an important normative goal: revitalizing the centrality of directors in corporate governance and making senior officers more accountable. As recently put by former Chief Justice E. Norman Veasey: "Statutory law provides that the corporation shall be managed by or under the direction of the board of directors. That means that the directors are in charge! They are not merely advisors to the CEO. They are the people who hire and fire the CEO." Professor Conard put it even more tersely almost thirty years ago: "[officers should] manage the business ... not manage the board of directors." Notice Professor Conard put it even more tersely almost thirty years ago: "[officers should] manage the business ... not manage the board of directors."143 Professor Conard put it even more tersely almost thirty years ago: "[officers should] manage the business ... not manage the board of directors."144

This Article favors the second response. Corporate governance reform in response to the scandals of the 1990s has come largely from Congress, the SEC, the NYSE, and Nasdaq. These

143. Veasey, supra note 64, at 842 (footnote omitted).
144. CONARD, supra note 94, at 371.
145. See supra note 6.
146. See supra note 7.
147. See supra note 8.
148. See supra note 9.
reforms have separately targeted directors and officers. \(^{149}\) Virtually no reform has come from states, the traditional source of corporate law rules. Although often overlooked by corporate fiduciary law's traditional emphasis on directors—itself an ironic state of affairs given that officers are regarded as the real holders of institutional power—agency law offers a set of substantive state law concepts well-suited to aid in the larger project of redressing the power imbalance between directors and officers. Toward the end of reclaiming a role for agency law in the multi-front effort to redefine director-officer relations in modern corporate governance, \(^{150}\) this Part first describes the fiduciary duties owed by officers as agents to their corporate principals and then elaborates on why the fiduciary status of officers is significant for contemporary corporate governance.

A. The Fiduciary Duties of Officers

Agency is a consensual relationship that embodies fiduciary obligations arising independently of contract. \(^{151}\) Even though senior officers of corporations typically have employment agreements, they still occupy a fiduciary status in relation to the corporate principal. \(^{152}\) As fiduciaries, officers owe several duties to the corporation that exist independently of contract—although they may, to a degree, be altered by agreement. \(^{153}\) Breach of these duties affords the corporate principal a host of remedies, including a tort action against the agent for losses caused by the breach. \(^{154}\) In effect, breach of these duties enables the corporation to assert that it is the victim of wrongdoing by the very persons who were to act on its behalf.

\(^{149}\) See supra notes 3-9 and accompanying text.


\(^{151}\) RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

\(^{152}\) See KLEINBERGER, supra note 66, at 125 (stating "an agent typically owes duties in contract as well as under agency law").


\(^{154}\) RESTATEMENT (SECOND) OF AGENCY § 399.
One cornerstone fiduciary duty owed by officers is a duty of loyalty, which requires the agent to act solely for the benefit of the corporate principal. There are many aspects to the agent's duty of loyalty. These include: not acting adversely to the principal without consent; not acting on behalf of one with interests adverse to the principal without consent; not competing with the principal; not wrongly appropriating a corporate opportunity; providing an accounting to the principal for profits; and not using or wrongly communicating confidential information. Moreover, as with the duty of loyalty for directors, an officer's duty may include not only a "non-betrayal" dimension, but also a more affirmative "devotion" aspect. This would require an officer to advance the well-being of the company, not simply refrain from harming it. What has not yet been required of an officer—unlike a director in a change of control setting—is an overarching duty or a situation-specific duty.

155. Id. § 387.
156. Id. §§ 389-390. A recent example involves the former President of Walt Disney Company, Michael Ovitz. See In re Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. Ch. 2003). Mr. Ovitz became President of Walt Disney Company before his employment agreement was finalized. Id. at 281. As such, he was an agent with interests adverse to his corporate principal and was subject to duties of loyalty and good faith, among others. Id. at 290. Ovitz recently failed to obtain a dismissal of the stockholder litigation against him because of his alleged breach of fiduciary duty. See id. at 291. Although it might have done so, the court did not ground Ovitz's fiduciary duties as president on agency principles. Moreover, the alleged wrongdoing of the Chief Executive Officer, Michael Eisner, also could easily have been based on breach of fiduciary duties owed as an agent of Walt Disney Company.

158. Id. § 393.
159. See Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1152 (Me. 1995) (adopting American Law Institute's approach regarding the usurpation of a corporate opportunity by a fiduciary of the corporation). As both Professor Deborah DeMott and Professor Jill Fisch pointed out to the authors, section 5.05 of the American Law Institute's Principles of Corporate Governance, cited by the Harris court, does distinguish the scope of an executive officer's duty with respect to a "corporate opportunity" from the duty of a non-executive director. See id. at 1150-52.

160. RESTATEMENT (SECOND) OF AGENCY § 388.
161. Id. §§ 395-396.
162. See Lyman Johnson, After Enron: Remembering Loyalty Discourse in Corporate Law, 28 Del. J. Corp. L. 27 (2003); see also RESTATEMENT (SECOND) OF AGENCY § 387 (agent must "act solely for the benefit of the principal in all matters connected with his agency").

163. Johnson, supra note 162, at 40.
to maximize the wealth of the corporation (or stockholders). Officers 
are to be loyal, but they are not legally constrained or governed 
by the stockholder wealth maximand. Nor is it clear whether officers' 
fiduciary duties extend to creditors when a firm enters the “vicinity 
of insolvency,” as is the case with directors. Creditors, however, 
might pursue the corporation’s own claim—as wronged principal—in a bankruptcy context.

Besides owing a duty of loyalty, officers owe a duty of ordinary 
care, and simple negligence is a breach of this duty. Additional 
important duties include a duty of good conduct, a duty to provide 
information and assist directors in understanding the significance 
of reported information—which probably should entail a “duty of

165. This difference may make officers better candidates than directors for achieving both fair and efficient outcomes, based on recent research by Professors Kent Greenfield and Peter C. Kostant. Kent Greenfield & Peter Kostant, An Experimental Test of Fairness Under Agency and Profit—Maximization Constraints (With Notes on Implications for Corporate Governance), 71 GEO. WASH. L. REV. 983, 1004-10 (2003) (finding that the director duty to maximize stockholder wealth may alter conduct more than an actor’s agency status).


168. See RESTATMENT (SECOND) OF AGENCY § 379 & cmt. (1958). The Restatement (Third) of Agency, in section 8.08, provides that “[u]nless otherwise agreed, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances....” RESTATMENT (THIRD) OF AGENCY § 8.08 (Council Draft No. 6, Sept. 30, 2004). Section 8.08 is the counterpart to section 379 of the Restatement (Second) of Agency. Id. reporter’s notes.


170. RESTATMENT (SECOND) OF AGENCY § 380.

171. Id. § 381. In a recent case, a de facto CFO and the corporation’s general counsel, both agents, were held liable for not informing the board of directors that the CEO was taking unauthorized loans at favorable interest rates. See Pereira v. Cogan, 294 B.R. 449, 523-24 (S.D.N.Y. 2003). It is unclear from the opinion whether the general counsel was held liable in his capacity as an officer or as a lawyer. Also, Vice Chancellor Leo Strine recently held Richard Scrushy, former CEO of Healthsouth Corporation, liable on an innocent misrepresentation theory, stating: “In the process of preparing and signing financial statements, Scrushy necessarily represented to the company’s board, audit committee, outside auditors, and its public stockholders that the financial statements his management team had
availability” for open discussion with directors as well as the reporting of “packaged” information—and a duty to obey the principal, among others. An agent who, for example, makes misrepresentations to a third party on behalf of a corporation, resulting in a claim by the third party against the corporation, has breached one or more of these fiduciary duties and should be held liable for resulting damages. By way of contrast, a corporate director owes fewer duties. These include a duty of loyalty (also multi-faceted) and duties of due care and good faith. The standard of culpability in the director due care decision-making context is also a looser standard of gross negligence, not the ordinary negligence standard applicable to agents.

One uncertainty concerning an officer’s duty of care is whether and how statutory specifications of standards for officers—for example, section 8.42 of the Model Business Corporation Act—and prepared were materially accurate in all respects.” In re Healthsouth Corp. S’holders Litig., 845 A.2d 1096, 1107 (Del. Ch. 2003). Moreover, the bankruptcy examiner in the Enron case found that Enron’s officers did not deliver all material information to the board and, “when information was presented,” it was “delivered in a manner not conducive to a full understanding.” Final Report of Neil Batson, Court-Appointed Examiner, at 94, In re Enron Corp., No. 01-16034 (AJG) (Bankr. S.D.N.Y. Nov. 4, 2003), http://www.enron.com/corp.por/pdfs/examinerfinal/NBFinalExecutiveSummary.pdf; see also Wooddale, Inc. v. Fidelity & Deposit Co. of Md., 378 F.2d 627, 634 (8th Cir. 1967) (stating that corporate officer’s failure to warn corporation of known wrongdoing constitutes breach of fiduciary duty).

172. “A recent survey of about 150 directors ... found that a majority wanted less packaged information and more time for open discussions.” Carol Hymowitz, How to Be a Good Director, WALL ST. J., Oct. 27, 2003, at R1. The CEO and COO of Enron—Kenneth Lay and Jeffrey Skilling, respectively—were criticized by the Bankruptcy Examiner because they “should have used their knowledge of the company to help the Outside Directors understand the information being presented.” Final Report at 118, In re Enron Corp., No. 01-16034 (AJG).

173. RESTATEMENT (SECOND) OF AGENCY § 385.

174. For a good, recent explanation of an agent’s fiduciary duties, see KLEINBERGER, supra note 66, at 117-28.


178. Model Business Corporation Act section 8.42, outlining standards of conduct for officers, provides:

(a) An officer, when performing in such capacity, shall act:

(1) in good faith;

(2) with the care that a person in a like position would reasonably
section 4.01 of the American Law Institute's Principles of Corporate Governance—alter the common law standard. By requiring an officer to act in good faith, both the Model Act and the ALI import into the officer duty context the burgeoning authority on good faith now emerging in the director setting. This requirement of good faith also qualifies an officer's statutory ability to rely on other persons. For example, officers who provide Sarbanes-Oxley certification in reliance on assurances from more junior employees or outside advisors may rely on those persons, for state fiduciary law purposes, only to the extent consistent with the officers' obligation of good faith. Consequently, recklessness, dishonesty, irrationality of action, and knowing violation of law, among other wrongs, may negate good faith.

exercise under similar circumstances; and
(3) in a manner the officer reasonably believes to be in the best interests of the corporation.
(b) In discharging those duties an officer, who does not have knowledge that makes reliance unwarranted, is entitled to rely on:
(1) the performance of properly delegated responsibilities by one or more employees of the corporation whom the officer reasonably believes to be reliable and competent in performing the responsibilities delegated; or
(2) information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by one or more employees of the corporation whom the officer reasonably believes to be reliable and competent in the matters presented or by legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the officer reasonably believes are matters (i) within the particular person's professional or expert competence or (ii) as to which the particular person merits confidence.
(c) An officer shall not be liable to the corporation or its shareholders for any decision to take or not to take action, or any failure to take any action, as an officer, if the duties of the office are performed in compliance with this section. Whether an officer who does not comply with this section shall have liability will depend in such instance on applicable law, including those principles of § 8.31 that have relevance.

179. See AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (1994).
180. See Johnson & Sides, supra note 6, at 1200-05; Sale, supra note 10, at 459-60.
181. See supra note 178; AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.02.
182. See Johnson & Sides, supra note 6, at 1220.
183. See supra note 178.
184. See Johnson & Sides, supra note 6, at 1201-04 (discussing the various wrongdoings that may negate compliance with the duty of good faith).
Importantly, the Model Act’s section 8.42, notwithstanding the general caption,185 is, like section 4.01 of the ALI’s Principles of Corporate Governance, a statutory duty of care only.186 Violations of the duty of loyalty and other duties of an agent, therefore, are not governed by this statute. The statute essentially adopts a “reasonable care” standard of behavior. It also states that an officer will not be liable if he or she complies with the statutory standard.187 As to whether noncompliance will lead to liability, the statute refers to “applicable law, including those principles of § 8.31 that have relevance.”188 The reference to “applicable law” is murky. If “applicable law” means agency law—which it should189—under established agency principles, the agent is clearly liable to the principal for any damage caused by the agent’s breach of duty.190 Moreover section 8.31—the director liability statute founded on policy rationales specifically pertinent to directors—should not be applied to lower the standards for senior officers with substantial operational responsibilities. Here, the failure to distinguish the officer as a fiduciary due to agency status—not facing the information or time hindrances of a director,191 receiving considerably greater compensation than the typical outside director,192 and not being “independent” in relation to the corporation—and a director with somewhat more distant and episodic responsibilities, is striking. A corporate director should be held to a lower standard—whether as low as section 8.31 is another issue—than a

185. See supra note 178.
186. See 2 MODEL BUS. CORP. ACT ANN. § 8.30 official cmt. at 8-162 (3d ed. Supp. 1998-1999) (“This standard of conduct is often characterized as a duty of care.”).
187. See supra note 178.
189. The official comment to section 8.42 refers to the “principles of agency” and specifically references section 379 of the Restatement (Second) of Agency. See 2 MODEL BUS. CORP. ACT ANN. § 8.42 official cmt. at 8-264. This point is reinforced in the introduction to the Model Act’s treatment of director conflicts of interest where it is stated as follows: “Conflicts of interest of non-director officers or employees of the corporation are dealt with by the law of agency prescribing loyalty of agent to principal.” 2 MODEL BUS. CORP. ACT ANN., ch. 8, subch. f, introductory cmt. at 8-374 (3d ed. Supp. 1997).
190. See supra text accompanying note 154.
191. See supra notes 97-99, 105 and accompanying text.
highly compensated senior officer with significant, ongoing, front-line managerial responsibilities.

The ALI devotes only a single cryptic paragraph in support of applying the same duty of care to officers and directors. It states, wrongly we believe, that "it is relatively well settled ... that officers will be held to the same duty of care standards as directors." We believe such an assertion is not at all well settled and, in fact, is false. The ALI comment goes on to assert, again wrongly we believe, that "[s]ound public policy points in the direction of holding officers to the same duty of care and business judgment standards as directors." As noted above, we believe policy considerations point to quite different standards for officers and directors, given their quite different roles, compensation, responsibilities, and overall position within the corporation.

The application of these officer fiduciary duties, as always is the case with fiduciary duties, will be influenced by the specific facts and circumstances in which the officer conduct arises. In addition, duties may vary depending on the particular office to reflect appropriate expectations concerning the professional skills and technical competence typically associated with the position—e.g., the positions of chief financial officer and general legal counsel. Moreover, just as officer operational duties are generally more expansive than those of directors, so too an officer's duties may vary based on the propriety of his or her reliance on another officer in a particular setting.

As noted earlier, only rarely do courts even address fiduciary duty claims against officers in their capacity as officers. Furthermore, when they do so it is rarer still for them to ground fiduciary duties on the agency status of officers. We have identified only five cases over the past twenty years—none of which came from Delaware and only one of which involved a public company—that link a corporate

194. Id.
195. Id.
197. See supra notes 46, 56 and accompanying text.
officer's fiduciary duty of care to the officer's status as an agent. Only three cited the standard of care set forth in the Restatement (Second) of Agency, and one of those three held that the business judgment rule overrode an agent's fiduciary duty and shielded a manager from liability for remarkable carelessness. A fourth decision inexplicably applied a gross negligence standard rather than the customary standard of ordinary care. In existing decisional law, it is not the case, as with directors, that there are many reported cases with plaintiffs only rarely prevailing; rather, with respect to officers, there are very few reported decisions at all. It is clear that the strong fiduciary duties associated with the agency status of corporate officers are having very little impact on judge-made law.

B. The Significance of Agency Status

1. The State Law Foundation

Unless state corporate law is simply going to cede responsibility for regulating corporate officers to the federal government, state law, through fiduciary duty law, must give a compelling account of why officers are expected to behave in certain ways. Even Congress in assigning responsibilities to corporate officers in the Sarbanes-Oxley Act must have been building on some unspoken conception of why officers should be assigned certain functions. Agency law provides a state law framework for those expectations. This is even more important today with the new calls for director “independ-
The result is likely to be fewer officers serving on boards of directors. As to non-director officers—a growing group—some theoretical basis for the imposition of fiduciary duties must, therefore, be articulated.

2. Fiduciary Duty

The rediscovery of the agency status of corporate officers is important to the fiduciary duty dimension of corporate governance. Currently there is simply no widely recognized conceptual grounding for the frequent doctrinal assertions that officers are fiduciaries. One might regard officer fiduciary status as *sui generis*, as is the case with directors, but there is no reason to do so. Officers undoubtedly are agents, and agents undoubtedly owe an array of fiduciary duties. Agency law, therefore, provides a pre-existing set of expectations that, although perhaps needing modification for adaptation to the modern corporation, does not require “starting from scratch” in fleshing out officer duties.

Forgetting agency law’s presence in corporate law leads, for example, to Professors Robert Thompson and Hillary Sale’s observation:

State law actually says very little affirmatively about what officers are supposed to do (in contrast to the relatively well-developed roles of directors and shareholders.) [By way of contrast,] Congress expressed its clear intent, through the Sarbanes-Oxley Act, to regulate the conduct of officers, in the context of the duties of care, loyalty, and good faith.

Recalling agency law concepts reveals that state law, in fact, says a great deal about the fiduciary duties of officers. Although it may or may not be better, as a normative or policy matter, to refine the

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204. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 864, 886 (2003). Professors Thompson and Sale also argue that federal securities law cases “are working to fill the hole in Delaware law brought about by the lack of liability for, and concomitant inability to sustain, suits for breaches of the officer fiduciary duty of care.” *Id.* at 905.
manner in which agency rules operate in corporate governance, positive law imposes the fiduciary duties of agency law on corporate officers. At the very least, this means the agency law duties of care and loyalty for senior officers are an integral, constituent part of corporate governance.

Appreciating this idea has potentially wide-ranging significance for the liability of senior officers. The duty of loyalty polices, among other wrongdoings, conflicts of interest and deliberate dishonesty. At least as important is the agent's duty of care. This obligation should hinder the efforts of senior officers to assert innocence based solely on ignorance in cases of wrongdoing by subordinates. Failure to exercise due care in such cases would give rise to a cause of action. In addition, as discussed above, agency law imposes an ordinary negligence standard of care that is tougher than the "gross negligence" standard applicable to corporate directors.

What this means in practical terms is, of course, highly context-specific, like the duty of care in the torts setting. There is no doubt, however, that this duty imposes on the appropriate senior officers the responsibility for establishing adequate internal monitoring procedures, including a system of financial controls sufficient to detect accounting improprieties and errors, as well as outright misappropriation of funds. Senior officers cannot blindly accept financial reporting from subordinates without some reason to have confidence in its reliability. Senior officers themselves owe the corporation a strong duty of care that they cannot discharge by leaving it up to the outside auditor or the audit committee of the board to vet financial statements for accuracy. In addition, senior officers need to ensure the existence of informational systems that are capable of revealing other kinds of illegal activities.

As agents of the corporation, officers bear primary responsibility for stewardship of the corporation's business activities and financial reporting. The board of directors' role then is to monitor senior officers' discharge of those duties. It is now clear that the board of

205. *See supra* notes 155-63 and accompanying text.
206. *See supra* notes 168-69, 177 and accompanying text.
directors, meeting only occasionally and lacking intimate knowledge of the corporation’s activities, is incapable of managing the publicly held corporation in a direct manner. Statutes like Delaware’s section 141(a) acknowledge this fact of corporate life, but also seem to imply that the board has somehow delegated its own managerial responsibility to the senior officers. Delaware’s statute, for example, speaks in terms of management “by or under the direction of” the board. \(^208\) Appreciating that senior officers are agents of the corporation should remind us that their fiduciary duties are original and derive from agency law, not from the board’s delegated statutory mandate to oversee the corporation’s business and affairs.

Recalling the agency status of officers also reveals that the fiduciary duty of care is no interloper in corporate law. Professors Edward Rock and Michael Wachter argue that the duty of care for directors has proven “troublesome” to corporate law as a “transplant” from the law of trusts and agency, \(^209\) leading courts to subdue its enforcement through the business judgment rule. \(^210\) With respect to corporate officers, however, no “transplant” into corporate law occurred or was necessary. Agency law was there all along, and, together with its robust duty of care, vitally shapes the officers’ relationship to the corporation. As chronicled in this Article, corporate law’s longstanding “neglect” of this status might arguably serve the same function with respect to the duty of care for officers as did judicial curbing of director care by means of the business judgment rule. Such a claim, however, is the exact opposite of that advanced by Rock and Wachter with respect to directors. Applied to corporate officers, the argument would be that a doctrine clearly already in corporate law must for some reason be expelled, whether by neglect or otherwise. That case has never been made.

\(^208\) DEL. CODE ANN. tit. 8, § 141(a) (2001).
\(^210\) Id. at 666-68. The business judgment rule, however, applies only where a deliberate judgment has been made. Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) (noting that the rule operates only in the context of director action). It therefore affords no protection within, and has no application to, the substantial sphere of director responsibility where no decision is made.
3. Officer Liability

Properly characterizing officers as agents carries strong potential for personal liability for breach of duty, particularly the duty of care. Currently most states, including Delaware, allow stockholders to reduce or eliminate director monetary liability for breaching the duty of due care. Most states do not extend this protection to officers. Delaware, for example, does not. Companies thus cannot by charter limit this exposure. A breach of due care by an officer—if an officer is regarded as an agent—may still result in an award of money damages. Moreover, in Delaware at least, the culpability standard for directors is gross negligence, whereas the customary standard of care for agents is that of ordinary care or simple negligence, a stricter fiduciary standard. Not only are officers thus held to a higher standard of care than directors, but unlike directors they may also be personally liable for breaching that standard. This fact, coupled with a 2004 change in Delaware law to provide for personal jurisdiction over corporate officers, may lead to renewed attention to the development of distinctive fiduciary rationales for the liability of officers. Recalling the agency status of officers supplies that rationale. Lumping directors and officers together as generic “fiduciaries,” by way of contrast, leads to neglect of that important status.

The heightened standard of care for corporate officers does not mean directors will routinely use litigation to pursue remedies for officer breaches of duty. It does accord directors considerable
leverage in their dealings with officers, however, and that leverage goes beyond the bargained-for terms of an employment agreement. Although tightly written employment contracts can make it very difficult to terminate senior officers "for cause," breaches of fiduciary duty create liability independently of contract. Improper behavior not warranting termination "for cause," thus may, nonetheless, constitute a fiduciary duty breach according to the principal various remedies. These, in turn, may alter the balance of power in favor of the corporation in negotiating a severance arrangement.

This leverage, when fully appreciated, will open a host of other issues. Senior officers may, before assuming office, seek to contract around agency-based liability by insisting on broad exculpation provisions in their employment agreements, specifically negating certain fiduciary duties (within the limits of public policy), relaxing the standard for discharging the fiduciary duty of care (and other duties), or eliminating monetary liability for breach of duties. A review of the employment agreements of Richard Grasso, former President of the NYSE, and Charles Conaway, former CEO of Kmart, reveals no efforts to contract around fiduciary obligations.

of Nortel Networks Corporation was demanding repayment of bonuses from fired executives); Rebecca Smith, DPL Sues 3 Top Executives Who Quit Under Cloud, WALL ST. J., Aug. 25, 2004, at B2 (detailing DPL's lawsuit against former executives for breach of contract and breach of fiduciary duty).

219. Lublin, supra note 57. Professors Stewart Schwab and Randall Thomas found that the most common grounds for "just cause" termination of a CEO, based on their review of 375 employment agreements, were moral turpitude (72.27% of all contracts), willful misconduct (69.07%), failure to perform duties (57.87%), and fiduciary breach (50.67%). STEWART J. SCHWAB & RANDALL S. THOMAS, WHAT DO CEO'S BARGAIN FOR?: AN EMPIRICAL STUDY OF KEY LEGAL COMPONENTS OF CEO EMPLOYMENT CONTRACTS (Vanderbilt Univ. Law School, Law & Econ. Working Paper No. 04-12, 2004), available at http://ssrn.com/abstract_id=529923.

220. Lublin, supra note 57 (describing the backlash against paying severance compensation to departing executives who engaged in wrongdoing). Although Professors Schwab and Thomas found that only about half of their sample employment contracts allowed a "just cause" termination for breach of fiduciary duty, SCHWAB & THOMAS, supra note 219, at 25, breach of duty would still subject the CEO to various remedies, whether or not it constituted "cause" for termination. Moreover, Professors Schwab and Thomas found that "poor performance" was not included as cause for termination in most CEO contracts. Id. Such conduct, however, would likely constitute a breach of an agent's fiduciary duty of ordinary care.

221. Professors Schwab and Thomas did not examine the frequency of CEOs contracting around fiduciary duties, except as a possible basis for a "cause" termination. They did find that most CEOs terminated for cause received no severance payment. SCHWAB & THOMAS,
Consequently, depending on the facts of those organizations' disputes with their former chief officers, fiduciary duty claims may exist.

Where there is attempted contracting around fiduciary duty, this invites a question as to the propriety of one fiduciary, the board of directors, relaxing the obligations of another fiduciary, senior officers. This issue is not present with director exculpation because stockholders themselves choose that outcome, not, as in the case with officers, directors who themselves owe fiduciary duties. Moreover, corporate lawyers, who now presumably fully explain director fiduciary duties, need to consider whether they must separately explain the contours of officer fiduciary duties. Even though corporate counsel does not represent corporate officers, summarizing expected fiduciary duties to an agent may comprise part of a lawyer's competent representation of the corporate principal's interests.

Furthermore, if directors choose not to pursue a valid breach of fiduciary duty claim against an officer—electing to drop it altogether or to resolve the matter in some other way—the question arises whether stockholders may initiate a derivative action. The action undoubtedly would challenge not only the directors' handling (or neglect) of the officer breach as itself a breach of director duty, but also seek to vindicate the underlying corporate claim against the breaching officer. Directors in that case may be sufficiently self-interested that demand on the board is excused. Directors,

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supra note 219, at 26.

222. Surely something is wrong if the former President of Disney, Michael Ovitz, testifies that he understood "duty of care" only in the context of a hospital. See Rita K. Farrell, Disney Directors on Trial for a Payout, N.Y. TIMES, Oct. 21, 2004, at C10.

223. Professors Geoffrey C. Hazard, Jr. and Edward B. Rock recently noted the inherent awkwardness of a corporate general counsel's relationship with, on the one hand, directors, and, on the other hand, officers: "The general counsel's relationship with the management team is precisely what gets in the way of the general counsel ("GC") guiding the independent directors through their governance obligations." Geoffrey C. Hazard, Jr. & Edward B. Rock, A New Player in the Boardroom: The Emergence of the Independent Directors' Counsel, 59 BUS. LAW. 1389, 1404 (2004) (analyzing the growing use of separate legal counsel for independent directors).

224. See, e.g., In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 291 (Del. Ch. 2003) (denying motions to dismiss derivative action against directors and former president); see also supra note 156 (examining In re Walt Disney Co. Derivative Litigation).

accordingly, must from the outset handle alleged officer fiduciary breaches in a manner that discharges their own fiduciary duties. They will not do so if the existence of officer duties—grounded in agency law—is not first brought to their attention.

4. The Business Judgment Rule

A claim that an officer breached a fiduciary duty will invite consideration of whether officers should receive the benefit of the business judgment rule when their conduct is judicially reviewed.\textsuperscript{226} There are fewer policy justifications for applying the business judgment rule to officers than directors,\textsuperscript{227} just as there are policy factors supporting greater liability risk for officers, compared to directors. Officers work full-time and receive significantly greater compensation than do directors, lessening the likelihood that they will decline to serve, or be deterred from taking risks, due to liability exposure. Their reward/risk ratio is higher than for directors, as is their overall level of responsibility. One would expect, given positive law and these policy factors, that officers would face a higher overall incidence of actual liability and a higher comparative incidence of liability than outside directors face.\textsuperscript{228} Yet, they do not. This suggests other factors, some of which we identified earlier,\textsuperscript{229} may be mitigating liability risk while raising the issue of whether we can conclude that such an outcome reflects a healthy and optimal level of exposure. Perhaps officers should face higher risk as legal theory suggests, but decisional law does not support that outcome.

Without the benefit of the business judgment rule—or some other method to reduce liability risk—an officer’s breach of duty leads straightforwardly to liability, avoiding the complexity of Delaware’s current approach to judicial review of director conduct\textsuperscript{230} and the

\textsuperscript{227} See id.
\textsuperscript{228} See BLACK ET AL., supra note 21, at 66 (describing liability exposure of directors).
\textsuperscript{229} See supra notes 56-57 and accompanying text.
\textsuperscript{230} See, e.g., Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995). For a critique of the unnecessary and faulty complexity introduced into fiduciary duty analysis by the Cinerama case, see Lyman Johnson, Rethinking Judicial Review of Director Care, 24 DEL. J. CORP. L. 787 (1999).
odd dichotomy between the standard of director conduct and the standard of judicial review. The point here, however, is that one gets to the business judgment rule issue—and the policy question of how much discretion it should accord officers—only after there is a clear underlying basis for imposing liability on corporate officers in the first place. Agency law provides that basis.

C. Corporate Governance Implications

1. Officers' Duty to the Corporate Enterprise

Much has been written about the appropriate content of directors' duties. Longstanding doctrine, as well as certain theoretical explorations, suggest a "shareholder primacy" understanding, according to which the board should attend first and foremost to the interests of shareholders whenever those interests conflict with those of non-shareholder constituent groups such as corporate employees, creditors, or local communities in which the company operates. Meanwhile, however, recent doctrinal developments suggest a broader conception of the director's role as mandating, or at least permitting, regard for the well-being of all of the corporation's stakeholders, including shareholders as well as non-shareholders. Legal theorists have offered arguments in support of this

231. See generally Melvin Aron Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 FORDHAM L. REV. 437 (1993). This "divergence" account of fiduciary duty analysis seems to have influenced not only Delaware law, but also the revised Model Business Corporation Act's Byzantine treatment of director conduct. See 2 MODEL BUS. CORP. ACT ANN. § 8.31 cmt. at 8-196 (3d ed. Supp. 1998-1999) (referencing Professor Eisenberg's divergence account).

232. See Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholder.").


234. Twenty-nine states have enacted statutes that expressly empower boards of directors to consider interests other than those of shareholders in exercising their decision-making powers. These "constituency" or "directors' duty" statutes vary in detail, but all include lists of specific non-shareholder constituencies, such as employees, creditors, or local communities in which corporations operate. See generally David Millon, Redefining Corporate Law, 24 IND. L. REV. 223 (1991) (examining directors' duty statutes, doctrinal implications to shareholder primacy, and the extent to which the statutes affirmatively compel management to protect the
At the moment, this important question awaits a definitive doctrinal or theoretical resolution.

This question should not arise in the case of senior officers. It is indisputable that officers are agents for the corporate enterprise, not the stockholders. Their responsibility to any particular corporate constituency is only indirect, and any benefits (or costs) to such groups are incidental effects that flow from decisions made in the interest of the corporation as a single, undifferentiated entity. Certainly agency theory provides no basis for the view that duties flow primarily to shareholders and that conflicts of interest between that group and any corporate constituency be resolved in favor of the former.

Seeing the matter in this way only begs the difficult question of what it means to conceive of officers' duties as running to the corporation. Is corporate profit-maximization (whether pursued

interests of non-shareholders); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEx. L. REV. 579 (1992) (analyzing corporate constituency statutes and their relationships to emerging case law). In a similar vein, at least in the special case of a board's response to certain types of hostile takeover bids, the Delaware Supreme Court has stated that directors might take into account "the impact [of the takeover] on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)." Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

235. So-called "progressive" corporate law scholars, critical of corporate law's traditional commitment to shareholder primacy, have advanced this position. For a representative collection of papers, see PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed. 1995); see also Johnson, supra note 125 (contrasting Easterbrook and Fischel's "contractual" model of the corporation with Bellah's more "organic" conception); Millon, supra note 234; Mitchell, supra note 234 (analyzing trend toward legal recognition of non-shareholder constituency interests); Marleen A. O'Conor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991) (arguing that corporations should be legally responsible for alleviating the harsh effects that corporate restructuring has on employees). For criticism of these views, see Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997) (reviewing PROGRESSIVE CORPORATE LAW, supra). Professors Margaret Blair and Lynn Stout have criticized the shareholder primacy norm on different grounds, using economic analysis to argue for a conception of the board of directors as mediator among the interests of the various participants in corporate production. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999). For criticism of their argument from a progressive point of view, see David Millon, *Essay, New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000) (questioning descriptive validity of team production model and distinguishing its normative implications from progressive reform proposals).
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with a short-term or longer-term focus) consistent with a notion of the corporation as an enterprise consisting of numerous participants, each of whose well-being affects the well-being of the corporation as a whole? Neglect of the idea that officers are agents of the corporation both explains and reflects the absence of careful thinking about this difficult question. Respect for officers' agency status demands that this oversight be addressed.

An appreciation of officers' status as agents of the corporate principal clarifies the appropriate standard governing the board's exercise of its authority. If the officers are supposed to act on behalf of the corporate entity—which comprises more than just the shareholders—it makes no sense to conceive of directors' fiduciary duties solely in terms of the shareholders. In addition to its own decision-making authority, the board is also charged with responsibility for monitoring the performance of the corporation's senior officers. A monitor held to one standard cannot impose its views of right conduct on agents whose responsibilities are defined differently. The result would be incoherent conceptually and unworkable as a practical matter. Instead, it should be understood that directors, in the discharge of their monitoring function, should evaluate officer performance by reference to the well-being of the corporation as a whole. A different metric—such as shareholder primacy—arguably could then guide the board's own decision-making functions. There would be a conceptual disconnect, perhaps, but the result would not be incapable of implementation.

2. Division of Governance Responsibilities

Agency law not only provides a conceptual grounding for officer fiduciary duties, but also offers a way to differentiate the governance functions of officers and directors, something too often blurred in corporate law and theory. Distinguishing director and officer functions enhances the larger project of revitalizing the board's central function in corporate governance—responsibility for monitoring the overall welfare of the company by meaningfully assuring that corporate officers advance firm interests. This is true, moreover, whether one believes that the board of directors should function primarily as a monitor seeking to advance stockholder interests or as a mediator concerned with balancing a broader set of
constituent interests vital to enterprise well-being. Although an investor-centered model and an enterprise-centered model may differ in other ways bearing on board composition and function, enhancing healthy director interaction with senior officers through sharper role differentiation is important under either board model. To be sure, however, conceiving of officers as agents of the enterprise should strengthen the position that the board itself must also act for the good of the enterprise as a whole, not simply on behalf of stockholders.

In post-Enron corporate governance, most regulatory reform has aimed to improve the board's functioning as an oversight/monitoring body. This is true in the Sarbanes-Oxley Act, SEC governance rulemaking, NYSE and Nasdaq rules, and various "blue ribbon" studies. These efforts seek to revitalize a movement that began thirty years ago, after the release of Professor Mace's distressing study of board dysfunction and the revelation of various corporate scandals. The aim was to improve board performance by reducing the size of the board, increasing the number of "independent" directors, and urging directors to reassert themselves more prominently in strategic planning and policymaking. By 1989, Professors Jay Lorsch and Elizabeth MacIver found that CEOs had


237. See Stout, supra note 25, at 687. Professor Bainbridge's "director primacy" model of corporate governance conceives of the board not as an agent of the stockholders but as embodying the interests of the corporate principal. See Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, The Board of Directors as Nexus of Contracts, 88 IOWA L. REV. 1 (2002). Although Bainbridge also believes, see Bainbridge, supra, at 563, that stockholders should be the beneficiaries of director efforts—a distinct and non-essential element, in our view, of a director-centered model—our agency conception of corporate officers supports Bainbridge's model of decision-making power in corporate governance.

238. See supra note 6.

239. See supra note 7.

240. See supra notes 8-9.


242. See Mace, supra note 69; see also DAVID VOGEL, LOBBYING THE CORPORATION: CITIZEN CHALLENGES TO BUSINESS AUTHORITY (1978) (describing corporate reform efforts being taken directly to firm management).
substantially less control over boards than earlier. This institutional realignment of power was thought by many financial theorists to be aided greatly by the influence of powerful market forces curbing officer misconduct, including pressures arising in product and service markets, labor markets, and capital markets. In addition, the 1990s saw an upsurge in activity by institutional investors, including the advocacy of even greater influence by independent directors.

Yet, notwithstanding those widespread reforms and the appeal of market-based constraints, CEO compensation and CEO control over compensation dramatically increased in the 1990s, as did corporate wrongdoing involving senior officers. Pay increases for CEOs not only skyrocketed in absolute terms, but the rate of increase also outstripped increases for other officers. One reason, now well known, is the rise of the stock option in CEO compensation, with its tendency to induce excessive focus on short-term stock price movements. By linking compensation to share price, it also led to efforts to manipulate financial data to overstate firm profitability.

Designing better managerial incentives to advance corporate and investor interests is part of needed reform. Several of the current reform efforts involve, as well, seeking to reestablish board power over corporate affairs to prevent officer misconduct. Congressional, SEC, and SRO rules all impose, in an ad hoc fashion, additional responsibilities at the director or officer level, thought necessary due to defects at the state law or market level. Violating these new mandates, however, carries no private cause of action. Fiduciary duty breaches, by way of contrast, do

243. See LORSCH & MACIVER, supra note 69, at 75-96.
245. See BAINBRIDGE, supra note 124, at 514-15 (describing academic interest in institutional investor activism).
246. See supra note 2.
247. See KAUFMAN ET AL., supra note 236, at 5-6.
248. See supra note 107.
250. See Johnson & Sides, supra note 6, at 1152 n.14.
support private claims for damages against officers. More funda-
mentally yet, contemporary reform efforts, like the earlier initia-
tives on which they build, fail to articulate an underlying theoretical 
understanding of the officers' governance role or fiduciary status.

The current regulatory effort to reassert—again—the primacy of 
the board would be enhanced greatly by conceiving of officers as 
agents of the corporation owing fiduciary duties. Even contractarian 
theorists, who disaggregate the “firm” into a nexus of contracts, 
view stockholder-manager relations as requiring a strong set of 
fiduciary rules to supplement the principal's need to monitor the 
agent.\textsuperscript{251} This theoretical call for fiduciary duties held great promise 
for re-emphasizing the fiduciary duties of officers as agents but for 
one problem. In positive law, officers are agents of the \textit{corporation}, 
not of the stockholders. Because contractarians disregard the 
corporation as such,\textsuperscript{252} they could not advocate officer duties running 
directly to stockholders without transgressing positive law, and 
they would not advocate officer duties running to the corporation 
because it would transgress their own model. These theorists, like 
more conventional corporate theorists, therefore failed to develop 
fiduciary duties of officers—or differentiate officer duties from 
director duties—as one component of good corporate governance.

Directors, in an entity conception of the firm, represent the 
interests of the corporation (the principal), whereas directors in a 
disaggregated nexus of contracts theory of the firm represent 
investors; in neither theory does anyone expect directors to “man-
age” corporate affairs. Management of corporate affairs instead 
largely falls to officers. Conceived in agency law terms, the inherent 
conflict of this arrangement emerges; the board sets officers in 
charge of responsibility for the \textit{principal}’s affairs, yet the officer 
so charged is also an \textit{agent}. In short, the same people are charged 
to act both as agents of the principal in third party dealings and 
as agents of the principal in assessing the performance of the 
principal’s own agents. They are not only the watched, but also the

\textsuperscript{251} See Easterbrook & Fischel, \textit{supra} note 244, at 700-03 (explaining the problem of 
divergent interests between corporate principals and agents, and how fiduciary rules and 
principles work to minimize this problem); Fischel, \textit{supra} note 244, at 1283-64 (arguing that 
market forces and legal rules can and should operate to reduce costs associated with the 
agency relationship between managers and shareholders).

\textsuperscript{252} See \textit{supra} notes 128-33 and accompanying text.
watchers. This untenable conflict is made evident by understanding officers as agents. Officers manage the corporate principal’s business but they do not and cannot monitor themselves on behalf of the principal. Unless market constraints or social norms are sufficient, other bodies—the board itself, various committees of the board, or independent auditors—must retain, and possibly divvy up, the function of overseeing officer performance. Revitalizing strong fiduciary duty rules for officers would not replace but would supplement these mechanisms with the aim of inducing greater attentiveness to corporate rather than officer welfare.

When the board itself does not delegate but directly manages a corporate function as, for example, in responding to a hostile takeover effort or approving a self-dealing transaction—each of which also implicates director self-interest—the board is effectively acting as an agent for the corporation and it cannot, in those instances, also monitor its own performance. In those cases of inherent conflict, corporate law principles provide for either greater stockholder voice or more searching judicial scrutiny as a safeguard. This same principle should apply to officers, and mechanisms and devices for alleviating their inherent conflicts must be developed or, in the fiduciary duty area, remembered.

At the functional level, viewing officers as agents, and the board and various board committees as the chief legal mechanism of the principal for monitoring officers, helps to differentiate these groups in the state corporate governance scheme. Such a conception also

253. Congressional initiatives directed at bolstering audit committees, as well as SEC, NYSE, and Nasdaq reforms aimed more broadly at reforming board committees, can be understood as mechanisms for upgrading the board monitoring function. NYSE and Nasdaq rules mandating not only independent audit committees, but also independent compensation committees and nominating/corporate governance committees, are quite detailed in their specifications. As just one example, under NYSE Rule 303(A)(4), the nominating/corporate governance committee “is also responsible for taking a leadership role in shaping the corporate governance of a corporation.” NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303(A)(4) commentary (2004), available at http://www.nyse.com/listed/102221393251.html (last visited Jan. 27, 2005). See generally Johnson & Sides, supra note 6.

254. See Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994) (stating that heightened judicial review of director conduct is required in certain cases and exercising such review in a change of control setting); Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) (noting that the fairness of a self-dealing transaction not approved by independent directors or ratified by stockholders may be challenged by the shareholders in a judicial forum).
places recent federal reforms in a new light. Although appearing to "federalize" corporate governance in unprecedented ways, recent reforms largely amount to a more detailed specification of director and officer functions that nonetheless builds on the state law-established provinces of responsibility.\textsuperscript{255} These reform efforts flesh out responsibilities of officers and directors but do not radically alter their traditional spheres of influence.

That those spheres became blurred is evidenced by longstanding references to the board and officers collectively as "management,"\textsuperscript{256} and by the failure of corporate law to differentiate the fiduciary status of officers and directors. Understanding corporate officers as agents can clarify these matters. No particular reform agenda flows out of an understanding of officers as agents. The point, rather, is that a core corporate governance interaction turns out to be an agency relationship, even though neither positive law nor corporate theory currently and robustly describes it in those terms. Those who believe the weighty fiduciary duties associated with that status are not beneficial for healthy corporate governance must make that case.

3. Board Composition and Selection

If a proper understanding of the board’s function emphasizes its responsibility to monitor the performance of senior officers on behalf of the corporation, common features of corporate governance that are already the subject of concern take on an even more troubling aspect. A number of companies have separated the CEO function from the board chairmanship.\textsuperscript{257} The notion is that the CEO should not exercise undue influence over the deliberations of the non-officer, independent directors. If, however, the board’s role is to monitor the performance of the corporation’s senior officers, one might well wonder why the CEO and, typically, other senior officers, have a place at the directors’ table at all.

\textsuperscript{255} See generally Johnson & Sides, supra note 6.
\textsuperscript{256} See supra notes 118-20, 142 and accompanying text.
No one would accept the notion that agents requiring monitoring should monitor themselves. The matter is not so stark in the case of a board in which a majority consists of independent directors. Even so, however, officer presence on the board does dilute the separation between the monitors and those to be monitored. There is certainly the ever-present danger that even a minority officer presence on the board could compromise the board's exercise of its monitoring responsibility. Accordingly, one might consider whether officers should participate in board meetings only by invitation, and in order to fulfill reporting responsibilities, seek counsel, or request approvals mandated by corporate statutes. Actual membership on the board might be foreclosed. At the very least, independent directors should be required or at least encouraged to meet separately from those directors who are also officers.258

Appreciation of the appropriate relation of the board to senior officers should also have implications for the selection process for board members. In many corporations today, the CEO effectively chooses "his" or "her" board through influence—even if informal—over the choice of director nominees.259 The shareholders then endorse those selections through the annual proxy solicitation process. Recalling the agency status of the CEO and other senior officers reveals the basic flaw in this arrangement. If the board's duty is to monitor the senior officers on behalf of the corporate principal, certainly it makes no sense for the agents to select, or to exert much influence over, the people charged with ensuring their accountability. Accordingly, nominations should be entrusted to a committee comprised entirely of independent directors. Input from the CEO may be acceptable, but the final decisions need to be made by the monitors, not by the persons being monitored.

258. This is now the practice with a number of boards. See, e.g., Ellen Bryon, Managers: Keep Out, WALL ST. J., June 21, 2004, at R4 (discussing the practice at eFunds Corporation). It is required by NYSE rules that "non-management directors of each company must meet at regularly scheduled executive sessions without management." NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A(3) (2004), available at http://www.nyse.com/listed/1022221393251.html (last visited Jan. 27, 2005).

259. See supra notes 65-66 and accompanying text.
CONCLUSION

Corporate officers occupy center stage in the Enron, WorldCom, Tyco, and other high profile corporate scandals that have drawn the attention of lawmakers and regulators. Much attention has been lavished on reinvigoration of the board of directors and its committees as a means to prevent similar wrongdoing. Meanwhile, the Delaware courts continue to elaborate regularly on the fiduciary duties owed by directors. Surprisingly, though, given their position of primacy in corporate management and the now well-known potential for abuse of that power, executive officers have not been the principal target of corporate law reformers. Furthermore, the question of their fiduciary status under state law has never received careful, thorough consideration by the Delaware judiciary. Instead, state fiduciary duty law—in Delaware and elsewhere—makes no distinction between the obligations owed by directors and those of officers. These two groups perform significantly different functions and bear quite distinct governance responsibilities in the modern public corporation, but they typically are simply lumped together and described generically as "fiduciaries." As such, there has been no effort to develop thoughtful analysis of the potentially different legal obligations owed by directors and officers to the corporation and its shareholders.

This failure to distinguish officers' fiduciary status from that of directors is puzzling, both because of the obvious importance of senior officers in corporate management, and also because there is a well developed body of legal doctrine that supplies the missing analytical framework. Agency law reminds us that officers are agents of the corporate principal and, as such, are subject to a well-developed set of fiduciary obligations that are inherent in the agency relationship. These include duties of loyalty and care, with the latter breached by simple negligence, in contrast to the gross negligence standard governing directors. These core responsibilities are supplemented by duties of good conduct, disclosure, and obedience. Violation of these duties can subject the agent to monetary liability to the principal for resulting injuries.

Agency concepts also illuminate the appropriate conceptual relationship between directors and officers, and the differing rationales for imposition of fiduciary duties. The corporate principal
is entitled to the benefit of its agents’ fiduciary responsibilities but, lacking human capacity, must act through the board of directors if it is to monitor, evaluate, and sanction officer behavior. Given this crucial difference in function, it makes no sense to think about director and officer fiduciary duty as part of a single, unitary body of legal doctrine.

It is not enough simply to note that officers are agents of the corporate principal and therefore subject to weighty fiduciary obligations that are inherent in the agency relationship and distinct from the doctrinal and policy considerations governing the duties of corporate directors. Once the agency status of corporate officers is appreciated, the more difficult task is to develop a more complete understanding of the content of their fiduciary obligations, the appropriate sanctions for breach, and the optimal standard for judicial scrutiny of alleged officer misconduct. These issues present a range of difficult policy questions. The answers will not be found in existing thinking about directors’ fiduciary duties. Non-management directors perform fundamentally different functions than officers—including monitoring of the officers’ performance—and therefore are presumptively subject to different duties.

Senior officers have been at the center of most of the recent corporate scandals. Agency law indicates that officers are subject to fiduciary duties more demanding than those governing directors. Exposure to personal liability for breach is more likely than it is for directors, because statutory exemptions do not apply and the application of the business judgment rule is at best uncertain. These special fiduciary duties—grounded in agency law—provide a far more potent mechanism for holding them accountable than does the usual notion of an undifferentiated fiduciary duty governing officers and directors alike. It is time to rediscover the true basis for officers’ fiduciary status and to begin the process of elaborating its practical implications.