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Situation-Specific Fiduciary Duties For Corporate Directors: Enforceable Obligations Or Toothless Ideals?

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SITUATION-SPECIFIC FIDUCIARY DUTIES FOR CORPORATE DIRECTORS: ENFORCEABLE OBLIGATIONS OR TOOTHLESS IDEALS?*

I. INTRODUCTION

A process of philosophical change is underway in the corporate world.[1] Judicial opinions, legislative acts, and scholarly legal articles are replete with evidence of dissatisfaction with the traditional idea that a corporation is a mere profit-making entity whose interests are equivalent to the interests of those who hold its stock.[2] Helping to replace the notion that the singular role of the corporation in our society is to maximize shareholder wealth is a realistic understanding that the modern corporation is a tremendously influential institution.[3] The emerging idea is that today's corporate directors—whose decisions have far-reaching effects on many more groups than just the corporation's shareholders—should consider the interests of the

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1. *See* Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 582-83 (1992) (noting broad questioning of paradigms underlying traditional corporate law); *Marketplace: Leadership in the 1990s* [hereinafter *Marketplace*] (American Public Radio broadcast, Sept. 7, 1992) (reporting on "paradigm shift" in corporate world); *see also* Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2214, 2245 (1992) [hereinafter Johnson, *Sovereignty*] (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) and ROBERT N. BELLAH, THE GOOD SOCIETY (1991) and predicting that 1990s will be "critical transitional period in corporate law and scholarship"); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 867 (1990) [hereinafter Johnson, *Meaning of Corporate Life*] (asserting that hostile takeover climate of late 1980s forced reconsideration of reason for corporate existence).

2. *See* David Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903, 905 (1988) (noting that takeover laws reject strictly shareholder-centered corporate thinking and represent deep questioning of basic premises of corporation law); Mitchell, *supra* note 1, at 584 (observing profound effect modern corporations' actions have on variety of groups in society); *Marketplace*, *supra* note 1 (reporting widespread adherence among business and legal professionals to idea that corporations are comprised of variety of stakeholders, not just stockholders); *infra* notes 34-76 and accompanying text (describing traditional model of corporate governance); *infra* notes 13-25, 89-108 and accompanying text (describing Delaware judiciary's trend away from corporate model embodying absolute shareholder primacy); *infra* note 9 (listing 28 state statutes that attempt to alter corporate dynamics).

3. *See* ROBERT N. BELLAH ET AL., THE GOOD SOCIETY 11 (1991) (maintaining that corporation's rights, duties, powers and responsibilities make it central institution and major force in America); Mitchell, *supra* note 1, at 584 n.18 (offering as example of corporations' societal influence, pinch that public felt when American oil companies raised gasoline prices in response to Iraq's 1990 invasion of Kuwait).

other groups whose fate they influence.[4] Board consideration of nonshareholder groups holding a stake in the corporation is especially imperative in situations in which the interests of one or more of these "stakeholder" groups are implicated to a greater degree than are shareholder interests.[5]

The traditional model's requirement that the board of a solvent corporation all but ignore the interests of everyone except the shareholders—no matter what the circumstances—has yielded inequities.[6] As the legal community has become increasingly aware of these inequities, it has begun to formulate alternative theories regarding the purpose of the public corporation in a free society.[7] In rethinking the question of corporate purpose, the law has recognized the need for director attention to the interests of corporate stakeholders other than shareholders and has attempted to accommodate this need.[8]

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4. *See* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 225 (1991) (stating that "number of nonshareholder constituencies depend upon the corporation for their welfare and are therefore affected directly by the manner in which management conducts the corporation's affairs"). *See generally* Mitchell, *supra* note 1, at 580 (documenting noticeable trend "toward detaching corporation's board of directors from its traditional, bipolar relationship with the corporation's stockholders"). Nonshareholder corporate constituencies include the corporation's creditors, employees, suppliers, community, and others. Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 45 (1991). They are also commonly known as "stakeholders." Nell Minnow, *Shareholders, Stakeholders, and Boards of Directors*, 21 STETSON L. REV. 197, 218 (1991).

5. *See* Mitchell, *supra* note 1, at 590 (suggesting that law match up situations with beneficiaries of fiduciary duties, marking off when directors' duties run to each corporate constituency). As an example of an instance where a nonshareholder group's interests are implicated uniquely, take the conflicting interests of shareholders and creditors of a financially troubled corporation. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991) (presenting hypothetical of almost insolvent corporation whose creditors and shareholders have opposing interests). As a corporation nears insolvency, the value of the shareholders' interests diminishes and the shareholders' appetite for risk grows. *Id.* At the same time, however, the creditors' interest in the corporation's ability to pay its debts becomes more acute and their appetite for risk is likely to be considerably smaller than that of the shareholders. *Id.* In that situation, it is the creditors' capital that is truly at stake and the fiduciary duties of corporate directors should reflect that reality. *Id.*

6. *See* Stone, *supra* note 4, at 45-47 (asserting that nonshareholders experience harm when directors protect shareholders' interests in making decisions about major corporate changes); *see also* Morey W. McDaniel, *Stockholders and Stakeholders*, 21 STETSON L. REV. 121, 156-57 (1991) (arguing that stakeholders cannot protect their interests contractually or statutorily); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163, 189-91 (1991) (same).

7. *See* Johnson, *Meaning of Corporate Life*, *supra* note 1, at 867 (observing that law is questioning reason for modern corporation's being); Millon, *supra* note 4, at 225 (articulating modern understanding that corporation's role in society is more complex than merely "shareholder wealth maximization"); *Marketplace*, *supra* note 1 (reporting that corporate thinkers are re-examining corporate purpose).

8. *See infra* note 9 and accompanying text (listing 28 states' legislative attempts to make corporate management responsive to needs of all stakeholders); *infra* notes 13-25, 89-108 (outlining judicial efforts in Delaware to increase director attention to interests of nonshareholder constituencies).

Nonshareholder corporate constituency statutes are, as one commentator put it, "the most obvious feature of th[is] reordering of the corporate legal landscape."[9] However, these statutes may well exacerbate the problem they purportedly seek to address.[10] By allowing but not requiring corporate directors to consider the interests of nonshareholders, and by not identifying situations in which directors should give special consideration to particular groups' interests, the majority of these statutes actually serve to *expand* directorial discretion.[11] The broad sweep of nonshareholder corporate constituency statutes, the discretionary tone most of them employ, and their failure to include enforcement provisions effectively leave corporate boards accountable to no one, not even the shareholders.[12]

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9. Mitchell, *supra* note 1, at 610. Twenty-eight states have enacted nonshareholder constituency statutes. ARIZ. REV. STAT. ANN. § 10-1202 (Supp. 1991); CONN. GEN. STAT. ANN. § 33-313(e) (West Supp. 1991); FLA. STAT. ANN. § 607.0830 (3) (West Supp. 1992); GA CODE ANN. § 14-2-202(b)(5) (Michie 1991); HAW. REV. STAT. § 415-35(b) (Supp. 1990); IDAHO CODE §§ 30-1602, 30-1702 (Supp. 1991); ILL. ANN. STAT. ch. 32, ¶ 8.85 (Smith-Hurd Supp. 1991); IND. CODE ANN. § 23-1-35-1(d), (f), (g) (West 1991); IOWA CODE ANN. §491.101B (West 1991); KY. REV. STAT. ANN. § 271B.12-210(4) (Michie/Bobbs-Merrill 1990); LA. REV. STAT. ANN. § 12:92(G)(2) (West Supp. 1992); ME. REV. STAT. ANN. tit. 13-A § 716 (West Supp. 1991); MINN. STAT. ANN. § 302A.251(5) (West Supp. 1992); MISS. CODE ANN. §79-4-8.30(d) (Supp. 1990); MO. REV. STAT. 351.347 (West Supp. 1991); NEB. REV. STAT. § 21-2035(c) (Supp. 1990); N.J. STAT. ANN. §§ 14-A:6-1(2), 6-14(4) (West Supp. 1991); N.M. STAT. ANN. § 53-11-35(D) (Supp. 1991); N.Y. BUS. CORP. LAW § 717 (b) (McKinney Supp. 1991); OHIO REV. CODE ANN. § 1701.59(E) (Baldwin Supp. 1990); OR. REV. STAT. § 60.357(5) (1989); 15 PA. CONS. STAT. § 1715 (1991); R.I. GEN. LAWS § 7-5.2-8 (Supp. 1991); S.D. CODIFIED LAWS ANN. § 47-33-4 (Supp. 1991); TENN. CODE ANN. § 48-35-204 (1988); WIS. STAT. ANN. § 180.0827 (West Supp. 1991); WYO. STAT. § 17-16-830(e) (1977) (enacted 1989).

The typical statute allows the board of directors to consider the interests of nonshareholder members of the corporate enterprise such as the managers, creditors, employees, suppliers, and community. *See* James J. Hanks, Jr., *Playing With Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 115-16 (1991) (describing typical statute); Stone, *supra* note 4, at 45-47 (listing nonshareholder constituencies that statutes typically protect). By contrast, Connecticut's nonshareholder corporate constituency statute is mandatory, requiring the board to consider the interests of those groups. CONN. GEN. STAT. ANN. §33-313(e) (West Supp. 1991).

10. *See* Stone, *supra* note 4, at 45-47 (explaining that nonshareholder constituency statutes aim to shield nonshareholders from harm they experience when directors protect shareholders' interests in making decisions about major corporate changes). *But see* Wallman, *supra* note 6, at 188-89 (contending that nonshareholder constituency statutes do not intend to create fiduciary duties running to stakeholders); *infra* notes 111-15 and accompanying text (discussing decreased director accountability and increased director protection under statutes). *See generally* McDaniel, *supra* note 6, at 122 n.2 (1991) (describing controversy over nonshareholder corporate constituency statutes and cataloguing articles in favor of them and against them).

11. Only one of the twenty-eight nonshareholder constituency statutes uses mandatory language. CONN. GEN. STAT. § 33-313(e) (1991).

12. *See* Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 24 (1991) (asserting that nonshareholder corporate constituency statutes "effect alarming changes" in officer and director accountability to shareholders); Mitchell, *supra* note 1, at 580 (citing concerns of Commissioner of Securities Exchange Commission and ABA Business Law Section that constituency statutes grant authority without accountability and create potential

Recent decisions under Delaware's common law of corporations offer greater hope for more modest, yet more effective, implementation of the philosophical shift away from the traditional conceptualization of the corporation.[13] Most importantly, in late 1991, in footnote fifty-five of *Credit Lyonnais v. Pathe Communications Corp.*,[14] Chancellor William Allen of the Delaware Court of Chancery addressed the potential for conflicting interests among corporate constituencies.[15] Less manipulable than the nonshareholder corporate constituency statutes, Chancellor Allen's footnote fifty-five is potentially a better shield for the interests of stakeholders other than shareholders.[16] Like the statutes, *Credit Lyonnais*'s footnote fifty-five indicates that directors should be *allowed* to consider the concerns of all stakeholders, but it apparently also goes further and *requires* the board to consider certain stakeholders' concerns under certain circumstances.[17]

Chancellor Allen explained in footnote fifty-five that the interests of the entire corporate enterprise, not just the shareholders, provide the proper

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for directorial mischief); *infra* notes 111-15, 149-56 and accompanying text (discussing how permissive nonshareholder constituency statutes practically eliminate board accountability).

The reader should note that even under the traditional model, the operation of the business judgment rule prevents courts from analyzing the merits of board decisions, thus weakening accountability of the board to the shareholders. *See infra* note 42 (explaining business judgment rule); *see also* Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. 1968) (holding that absent fraud, illegality or conflict of interest, board decisions are not reviewable by courts).

13. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989) (holding that aside from short-term shareholder gain, long-term preservation of "Time culture" is corporate interest that board may consider when evaluating takeover threat); Unocal Corp. v. Mesa Corp., 493 A.2d 946, 955 (Del. 1985) (suggesting that in board decision whether to defend against takeover attempt, interests of entire corporate enterprise, not just shareholders, are at stake); Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991) (indicating that directors should consider "entire corporate enterprise" in decisionmaking process); *see also infra* notes 89-108 and accompanying text (outlining judicial trend in Delaware towards increased directorial protection of interests of entire corporate enterprise).

14. Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

15. Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991).

16. *See infra* notes 137-42 and accompanying text (arguing that using creditors of insolvent corporations as example, in footnote 55, Chancellor Allen may have begun to create situation-specific duties for corporate directors).

17. *See Credit Lyonnais*, 1991 WL 277613, at *34 (holding that "[a]t least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk-bearers, but *owes its duties* to the corporate enterprise") (emphasis added); Gregory V. Varallo & Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239, 241 (1992) (acknowledging *Credit Lyonnais*'s creation of duties to nonshareholder constituencies—especially creditors—of financially troubled corporations); *see also* Wallman, *supra* note 6, at 188 (arguing that statutes do not intend to create directorial fiduciary duties running to nonshareholders). *But see* Stone, *supra* note 4, at 47 (maintaining that statutes, as well as case law, create directorial fiduciary duties running to nonshareholders).

frame of reference for a director making decisions on behalf of a solvent corporation nearing insolvency.[18] The Chancellor also recognized that when a corporation is teetering on the verge of insolvency, the interests of the corporate creditors are particularly pertinent.[19] Thus, Chancellor Allen implied that in a given decisionmaking process, the identity of the beneficiaries

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18. *Credit Lyonnais*, 1991 WL 277613, at *36 n.55. Footnote 55 reads as follows:

> The possibility of insolvency can do curious things to incentives, exposing creditors to risks of opportunistic behavior and creating complexities for directors. Consider, for example, a solvent corporation having a single asset, a judgment for $51 million against a solvent debtor. The judgment is on appeal and thus subject to modification or reversal. Assume that the only liabilities of the company are to the bondholders in the amount of $12 million. Assume that the array of probable outcomes on appeal is as follows:

		Expected Value
25% chance of affirmance	($51mm)	$12.75
70% chance of modification	($4mm)	2.8
5% chance of reversal	($0)	0
Expected Value of Judgment on Appeal		$15.55

> Thus, the best evaluation is that the current value of the equity is $3.55 million ($15.55 million expected value of judgment on appeal - $12 million liability to bondholders). Now assume an offer to settle at $12.5 million (also consider one at $17.5 million). By what standard do the directors of the company evaluate the fairness of these offers? The creditors of this solvent company would be in favor of accepting either a $12.5 million or a $17.5 million offer. In either event they will avoid the 75% risk of insolvency and default. The stockholders, however, will be plainly opposed to acceptance of a $12.5 million offer (under which they get practically nothing). More importantly, they very well may be opposed to acceptance of the $17.5 million offer under which the residual value of the corporation would increase from $3.5 to $5.5 million. This is so because the litigation alternative, with its 25% probability of $39 million outcome to them ($51 million - $12 million = $39 million) has an expected value to the residual risk bearer of $9.75 million ($39 million x 25% chance of affirmance), substantially greater than the $5.5 million available to them in the settlement. While in fact the stockholders' preference would reflect their appetite for risk, it is possible (and with diversified shareholders likely) that shareholders would prefer rejection of both settlement offers.
>
> But if we consider the community of interests that the corporation represents it seems apparent that one should in this hypothetical accept the best settlement offer available provided it is greater than $15.5 million, and one below that amount should be rejected. But that result will not be reached by a director who thinks he owes duties directly to the shareholders only. It will be reached by directors who are capable of conceiving of the corporation as a legal and economic entity. Such directors will recognize that in managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.

Id.; *see also infra* note 101 (listing support for Chancellor Allen's view that directorial fiduciary duties run to entire corporate enterprise).

19. *See Credit Lyonnais*, 1991 WL 277613, at *36 n.55 (stating that possibility of insolvency exposes creditors to "risks of opportunistic behavior").

of the directors' fiduciary duties should depend on the specific corporate circumstances.[20]

Because a corporation's creditors are the primary stakeholders in the situation of near insolvency, Chancellor Allen suggested that in discharging their fiduciary duties, directors of financially troubled corporations should be especially protective of the creditors' interests.[21] Under other circumstances, the corporation's employees, for example, may be the constituency that managerial misconduct stands to hit the hardest.[22] When that is the case, by extension of the logic of footnote fifty-five, the board should be most solicitous in sheltering the employees' interests.[23]

With *Credit Lyonnais*'s footnote fifty-five, Chancellor Allen has nudged Delaware law in the direction of establishing directorial fiduciary duties running to nonshareholders in at least some circumstances.[24] Footnote fifty-five could therefore represent a major turning point in the law of corporations in Delaware and elsewhere.[25] Unfortunately, however, it leaves two crucial questions unanswered.

The first omission concerns the scope of the footnote's applicability. To what class of situations did Chancellor Allen intend his reasoning in footnote fifty-five to extend? On the surface at least, the footnote appears limited in its application and noncommittal in its tone.[26] Clearly, the

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20. *See id.* (indicating that directors should recognize that "*circumstances may arise* when the right . . . course to follow for the corporation may diverge from the choice that the stockholders (. . . or any single group interested in the corporation) would make if given the opportunity to act") (emphasis added).

21. *See id.* (stating that possibility of insolvency exposes creditors to "risks of opportunistic behavior" and using hypothetical to show that directors of almost insolvent corporation should protect creditors' interests even if such action is in opposition to shareholders' interests).

22. *See* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1203-10 (1991) (arguing that when corporations are considering restructurings and plant closings, directors' fiduciary duties should run to employees); Stone, *supra* note 4, at 45 (observing that employees are most often cited as constituency in need of protection).

23. *See* Mitchell, *supra* note 1, at 590 (arguing in favor of situation-specific directorial fiduciary duties). This Note does not purport to identify specific factual circumstances under which corporate directors' fiduciary duties should shift from being owed to the shareholders to being owed to another specific constituency. Rather, this Note attempts to place *Credit Lyonnais*'s footnote 55 into its legal context and demonstrate its potential as an instrument for courts to use in extending existing principles or creating new doctrine.

24. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*).

25. *See Footnote of the Year Has Lawyers Wondering About the Zone of Insolvency*, 24 Sec. Reg. & L. Rep. (BNA) 388, 388 (Mar. 20, 1992) [hereinafter *Footnote of the Year*] (reporting that footnote 55 "appears to indicate a deviation from well-settled Delaware principles"). The potential change in Delaware law carries added significance because many consider Delaware the source of American corporation law. *See, e.g.*, Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 87 (1990) (calling Delaware law "our national corporate law").

26. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*). The footnote only discusses the duties of directors of corporations on the verge of insolvency. *Id.* Moreover, the footnote takes a normative approach, saying what a responsible director "should" do and not

Chancellor endorsed the corporate enterprise theory on some level and invoked it in the near-insolvency context.[27] In so doing, he may have aimed solely to expose and alleviate the plight of creditors of almost-insolvent corporations, without recognizing any directorial duties to creditors or other nonshareholders under any other circumstances.[28] On the other hand, Chancellor Allen may have used the predicament of corporate creditors in the near-insolvency situation as an example to make the broader point that the identity of the beneficiaries of directorial duties should vary as a function of the subject matter of the decision facing the board.[29] Thus, the Chancellor may have meant to indicate that board action should reflect an awareness of which stakeholders have the most to lose if the directors embark on any particular proposed course of action.[30]

The second and more significant omission of footnote fifty-five is its failure to address whether the Delaware courts will couple the newly recognized duties—whatever their scope—with a mechanism for their enforcement.[31] While the footnote signals that corporate law may be turning a philosophical corner, the turn will be useless, and the protection of the interests of nonshareholders will remain a fiction, as long as shareholders are the only corporate constituency with standing to enforce directors' fiduciary obligations.[32] If standing to bring a derivative suit remains available exclusively to the corporation's shareholders, only theorists and academics will enjoy the ground Chancellor Allen broke with *Credit Lyonnais*'s foot-

what she "must" do. *Id. But see* Varallo & Finkelstein, *supra* note 17, at 241 (calling what Chancellor Allen created in footnote 55 directorial fiduciary "duties" to nonshareholder members of corporate enterprise on verge of insolvency).

27. *See* Daniel J. Winnike, *Credit Lyonnais: An Aberration or an Enhancement of Creditors' Rights in Delaware*, 6 INSIGHTS 31 (July 1992) (stating that footnote 55 expands range of situations in which directors are fiduciaries of creditors to include near insolvency); *supra* note 18 (quoting footnote 55 as stating that directors should be "capable of conceiving of the corporation as a legal and economic entity" and should consider "community of interests").

28. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*).

29. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991) (holding that "in the management of the business affairs of a solvent corporation in the vicinity of insolvency, *circumstances may arise* when the right . . . course to follow for the corporation may diverge from the choice that . . . any single group interested in the corporation would make if given the opportunity to act") (emphasis added).

30. *See* McDaniel, *supra* note 6, at 146-47 (maintaining that while stakeholder statutes presently confer no legally enforceable rights, perhaps courts will later "recognize that directors owe enforceable duties to *some stakeholders in some cases, particularly primary stakeholders when they are being expropriated*") (emphasis added); Mitchell, *supra* note 1, at 590 (arguing in favor of situation-specific directorial fiduciary duties).

31. *See Footnote of the Year*, *supra* note 25, at 388-89 (reporting that members of Delaware bar are questioning what if any enforcement mechanism footnote 55's duties will carry).

32. *See id.* (describing footnote 55 as "deviation from well-settled Delaware principles," but asking "where in the practical world a party can obtain a remedy" for breach of the footnote's principles).

note fifty-five. Neither creditors nor other stakeholders will be able to utilize the footnote's rationale to safeguard their corporate interests.[33]

After outlining some of the basic legal tenets of the traditional model of corporate governance, this Note examines the effects of the nonshareholder corporate constituency statutes and the effects of the Delaware case law that advances the corporate enterprise notion. An analysis of two alternative readings of *Credit Lyonnais*'s footnote fifty-five then follows. Finally, the Note concludes that under either reading, footnote fifty-five's lack of an enforcement mechanism renders ethereal the benefit it confers upon creditors or all nonshareholder constituencies.

II. The Traditional Model of Corporate Governance

To traditional corporate law theorists, making profit for investors is the singular normative focus of the corporation.[34] In other words, the reason for corporate existence is to maximize shareholder wealth.[35] Because the shareholders are said to "own" the corporation, conventional corporate theory maintains that their interests *are* the interests of the corporation.[36] Accordingly, under the traditional model of corporate governance, directors conducting a corporation's affairs should have a sole objective: boosting shareholder gain.[37]

A. Directors' Fiduciary Duties Under the Traditional Model

The traditional model's broad notion that the corporate purpose in society is to increase shareholder profits necessarily colors its more specific determination of the relative rights and duties of the various players on the corporate field. The model binds the directors to the corporation *and* its shareholders[38] by a duty of loyalty and a duty of care.[39] In keeping with

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33. *But see id.* at 388-89 (suggesting that footnote 55's corporate enterprise concept is foundation for argument that nonshareholders should have access to derivative suit).

34. *See* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 256 (7th Cir. 1986) (holding that traditional goal of corporation in capitalistic society is "stockholder wealth maximization"), *rev'd on other grounds*, 481 U.S. 69 (1987); *see also* Millon, *supra* note 2, at 903, 911-18 (pointing out that for past several decades, legal theory has held that "[a] corporation exists for the financial benefit of its shareholders [and] management must devote itself to this single purpose with relentless fidelity"; describing development of traditional model's shareholder primacy principle which culminated in hostile takeover craze).

35. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (1919) (prohibiting director action designed to create jobs and make less expensive cars because those goals did not comport with singular corporate purpose of advancing profit-making interests of shareholders); Adolph A. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932) (stating that corporations exist for sole purpose of making profits for their stockholders).

36. *See* Mitchell, *supra* note 1, at 586 (citing traditional model's abiding theory that shareholders own corporation as reason for law's equating corporate interests with shareholder interests). *But see* McDaniel, *supra* note 6, at 149-50 (arguing that modern corporation is nexus of contracts and has no owners).

37. *See infra* notes 44-47 and accompanying text (discussing Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) and its absolute shareholder primacy principle).

38. *See* Mills Acquisition Co. v. McMillan, Inc., 559 A.2d 1261, 1280 (Del. 1989)

the traditional philosophical position that increasing shareholder profits is the singular corporate aim, however, the law equates the corporation with its shareholders.[40] Thus, under the law of Delaware and other states, courts often state that the directors are fiduciaries of the shareholders.[41] The board's fiduciary role vis-à-vis the shareholders limits the actions that the directors legitimately can take.[42]

The board of directors of a solvent corporation does not owe fiduciary duties to other corporate stakeholders, such as creditors.[43] In fact, according

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(holding that directors owe fiduciary duties to "corporation and its shareholders"); Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (same); Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (same); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (same); WILLIAM E. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.06, at 12 (3d ed. 1978) (reciting generally accepted rule that directors occupy special fiduciary relationship to corporation and its shareholders).

Cases holding that directors owe fiduciary duties to the corporation and the shareholders refer to the shareholders as a unit; no directors' fiduciary duties run to the shareholders individually. *See In re* Black, 787 F.2d 503 (10th Cir. 1986) (holding that shareholders are collective, not individual, beneficiaries of directors' fiduciary duties).

The notion that directors owe fiduciary duties to the corporation *and* its shareholders may not be entirely accurate. *See infra* note 101 (listing support for position that directors are fiduciaries of corporation itself).

39. *See* Norlin Corp. v. Rooney, Pace, Inc., 744 F.2d 255, 264 (2d Cir. 1984) (stating that directors owe duty of loyalty and duty of care); *In re* Suburban Motor Freight, Inc., 124 B.R. 984, 1004 (Bankr. S.D. Ohio 1990) (same); Air Line Pilots Association Int'l. v. UAL Corp., 717 F. Supp. 575, 581 (N.D. Ill. 1989) (same); MARC J. LANE, REPRESENTING CORPORATE OFFICERS AND DIRECTORS 44 (1987) (same); Alfred F. Conard, *A Behavioral Analysis of Directors' Liability for Negligence*, 1972 DUKE L.J. 895, 895 (same).

The duty of loyalty requires directors to act in good faith and in the corporation's best interest. *Revlon*, 506 A.2d at 180; Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983). In its typical formulation, the duty of care requires a director to exercise the care that an ordinary prudent person in a like position would exercise under similar circumstances. REVISED MODEL BUS. CORP. ACT § 8.30(a)(2). In Delaware, the duty of care demands that directors exercise diligence and an informed business judgment. Balotti & Gentile, *Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 15 (1987).

40. Mitchell, *supra* note 1, at 586-87; *see also infra* note 64 (describing Professor Mitchell's theory that public misconception that shareholders are sole beneficiaries of directors' duties is outgrowth of traditional model's standing rules).

41. *See* Simons v. Cogan, 549 A.2d 300, 304 (Del. 1988) (stating that directors owe duties to shareholders because ownership is basis for fiduciary duty). *But see* Mitchell, *supra* note 1, at 580-81 (characterizing idea that shareholders are exclusive beneficiaries of directors' fiduciary duties as notion that needs to be put to rest); *infra* note 101 (listing support for position that directors are corporation's fiduciaries).

42. Courts assess the corporate director's duties in light of the "business judgment rule," a judicial presumption that in making a business decision, the directors have acted in good faith and in a manner they reasonably believe to be in the best interests of the corporation. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Therefore, some argue that the limits that directorial fiduciary duties place on the actions of directors are minimal. *See* Macey, *supra* note 12, at 24 (implying that even if nonshareholders become beneficiaries of fiduciary duties, business judgment rule will protect most directors' actions, making the duties less valuable).

43. *See In re* Revco D.S., Inc., 118 B.R. 468, 507-08 (Bankr. N.D. Ohio 1990) (noting that Delaware courts consistently have refused to recognize that corporate directors owe creditors fiduciary duties); Browning Debenture Holders' Comm. v. DASA Corp., 454 F.

to a fairly recent Delaware Supreme Court decision, *Revlon v. McAndrews & Forbes Holdings, Inc.*,[44] the law actually *forbids* directors of a solvent corporation from acting out of concern for the interests of other corporate constituencies when such action would be inconsistent with their duties to the shareholders.[45] Under *Revlon*, only when concern for other corporate constituencies will cause the accrual of some rationally related benefit to the stockholders is director action based on such concern proper.[46] In other words, the directors' duties run to the shareholders exclusively.[47]

The Delaware Supreme Court's holding in *Revlon* comports with Chancellor Allen's holding just three days earlier in *Katz v. Oak Industries*.[48] In *Katz*, Chancellor Allen wrote the following with regard to directors' duties in the face of conflicting interests of shareholders and creditors:

> It is the obligation of the directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so "at the expense" of others . . . does not for that reason constitute a breach of duty. It seems likely that corporate restructurings designed to maximize shareholder values may in some instances have the effect of requiring bondholders to bear greater risk of loss and thus in effect transfer economic value from bondholders to stockholders.[49]

Unsheltered by the same broad fiduciary duties that corporate shareholders enjoy from the directors, corporate creditors must, under the traditional model, look to the terms of their contracts with the corporation for determination of their rights and for protection from director mismanagement.[50] In *Katz*, Chancellor Allen articulated the prevailing explanation for extending only contractual protection to creditors.[51] He wrote that because agreements between a corporation and its creditors typically are negotiated thoroughly and documented extensively, the rights and obligations of each party should be evident from the documentation.[52] Therefore, the contractual

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Supp. 88, 104 (S.D.N.Y. 1978) (stating legal conclusion that neither corporation nor directors owe fiduciary duties of any kind to corporate creditors); Kessler v. General Cable Corp., 155 Cal. Rptr. 94, 103 (App. Dep't. Super. Ct. 1979) (opining that to declare that director could breach fiduciary duty owed to corporate creditors "would constitute an expansion at divergence with much of the current case law"); *see also* McDaniel, *supra* note 6, at 146 n.89 (listing articles that favor and articles that oppose idea of directors owing fiduciary duties to creditors).

44. 506 A.2d 173, 182 (Del. 1986).

45. Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986); *see also* Minnow, *supra* note 4, at 217 n.78 (noting that traditional corporate law permits concern about nonshareholder constituencies, but only "in the context of the shareholders").

46. *Revlon*, 506 A.2d at 176.

47. *Id.*

48. 508 A.2d 873 (Del. Ch. 1986).

49. Katz v. Oak Indus., 508 A.2d 873, 879 (Del. Ch. 1986).

50. *See id.* (holding that corporate directors owe no extra-contractual protection to corporate creditors); Harff v. Kerkorian, 324 A.2d 215, 219 (Del. Ch. 1974) (holding that contracts determine creditors' rights), *aff'd in part, rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975).

51. *Katz*, 508 A.2d at 879.

52. *Id.*; *See also* Hanks, *Playing With Fire*, *supra* note 9, at 115-16 (maintaining that

terms to which both parties have agreed and not any broader notion, such as fairness or equity, should dictate the corporation's obligation to its creditors.[53]

Even with the traditional model of corporate governance firmly in place, Delaware courts have carved out an "insolvency exception" to the rule that directors do not owe fiduciary duties to corporate creditors.[54] The rationale behind the exception is that insolvency is a "special circumstance" warranting departure from the general rule that directors do not owe creditors duties beyond the relevant contractual terms.[55] Once a corporation reaches insolvency, traditional legal theory recognizes the vulnerability of corporate creditors and requires that the corporation's directors protect the interests of its creditors.[56]

Recently, in *Geyer v. Ingersoll Publications Co.*,[57] the Delaware Court of Chancery reiterated the insolvency exception, holding that insolvency creates fiduciary duties on the part of directors for the benefit of creditors.[58] The issue in *Geyer* was whether, for purposes of creating those fiduciary

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nonshareholders—especially creditors and employees—do not need protection of directorial fiduciary duties because other protection is available to them: "economic interests of employees, for example, are protected by minimum wage, safety, health and plant-closing laws, and in many cases, collective bargaining agreements [and] [c]reditors are protected by fraudulent conveyance, preference and bulk transfer statutes as well as by contract"); Hideki Kanda, *Debtholders and Equityholders*, 21 J. LEGAL STUDIES 431, 440 (1992) (arguing that debtholding should remain creature of contract with individual debtholders choosing contractual terms consistent with debtholder's own perception of risk involved in making loan); Macey, *supra* note 12, at 36-37 (arguing that shareholders have most need for directors' fiduciary allegiances because shareholders face "more daunting contracting problems than other constituencies" do, and describing as "flawed and without merit" argument that employees' contracts with corporation reflect employees' lack of bargaining power). *But see* McDaniel, *supra* note 6, at 156-57 (taking issue with argument that stakeholders can protect their interests contractually or statutorily); Stone, *supra* note 4, at 54-69 (arguing that contract-based solutions do not offer adequate protection for corporate employees in many situations); Wallman, *supra* note 6, at 189-91 (same).

53. Katz v. Oak Indus., 508 A.2d 873, 879 (Del. Ch. 1986).

54. *See* Geyer v. Ingersoll Publications Co., Civ. A. No. 12406, 1992 WL 136743, at *3 (Del. Ch. June 18, 1992) (characterizing insolvency exception as undisputed); Harff v. Kerkorian, 324 A.2d 215, 219 (Del. Ch. 1974) (recognizing insolvency exception), *aff'd in part, rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975). *But see* Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821, 1843 n.68 (1992) (questioning doctrinal basis for insolvency exception and noting that courts do not frequently invoke it).

55. *Harff*, 324 A.2d at 219. In addition to insolvency, other "special circumstances" warranting a departure from the traditional rule that directors are not fiduciaries of creditors include fraud, and a director's violation of statute. *Id.*

56. Ford Motor Credit Co. v. Minges, 473 F.2d 918, 921 (4th Cir. 1973); *Geyer*, 1992 WL 136743, at *2; *Harff*, 324 A.2d at 219; *see also* Millon, *supra* note 2, at 910 (explaining that insolvency exception grew out of nineteenth century understanding that creditors of insolvent corporations are particularly vulnerable).

57. Civ. A. No. 12406, 1992 WL 136743 (Del. Ch. June 18, 1992).

58. Geyer v. Ingersoll Publications Co., Civ. A. No. 12406, 1992 WL 136743, at *2 (Del. Ch. June 18, 1992).

duties, insolvency occurs at the moment of insolvency-in-fact or at the institution of statutory proceedings.[59] In confronting that question, the court explained that underlying the exception is the idea that a corporation's reaching insolvency results in the creation of a trust for the benefit of the corporate creditors.[60] Based on Delaware precedent and on the ordinary meaning of the word "insolvency," the court then held that it is the fact of insolvency—achieved at the moment when the corporation's liabilities exceed its assets[61]—that causes the trust to arise.[62]

B. *Standing to Sue for Breach of Directors' Fiduciary Duties Under the Traditional Model*

As a corollary to the idea that shareholders are the only beneficiaries of directorial fiduciary duties,[63] the traditional law allows only the shareholders, as "owners" of the corporation, to maintain derivative suits on the corporation's behalf for breach of the directors' fiduciary duties.[64]

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59. *Id.*

60. *Id.*

61. *Id.*; *see also* Bovay v. H.M. Byllesby & Co., 38 A.2d 808, 813 (Del. 1944) (citing McDonald v. Williams, 174 U.S. 397 (1899), in which Court defined insolvency as having fewer assets than liabilities).

62. *Geyer*, 1992 WL 136743, at *2. F

63. *See* Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) (holding that shareholders are exclusive beneficiaries of directors' fiduciary duties). *But see infra* note 64 (providing Professor Mitchell's argument that traditional model's standing rules caused inaccuracy in public understanding of fiduciary duties).

64. *See* Kaufman v. Dreyfus Fund, Inc., 434 F.2d 727, 735 (3d Cir. 1970) (recognizing "unambiguous requirement—amounting to a legal principle" that nonshareholder cannot bring derivative action), *cert. denied*, 401 U.S. 974 (1971); Kusner v. First Pa. Corp., 395 F. Supp. 276, 280-83 (E.D. Pa. 1975) (holding that only shareholders have requisite legal standing to bring derivative suit on behalf of corporation); Dorfman v. Chem. Bank, 56 F.R.D. 363, 364 (S.D.N.Y. 1972) (requiring shareholder status for standing to bring derivative suit); Lawrence E. Mitchell, *Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165, 1192-93 (1990) (noting that stockholder standing to bring derivative suit is based on idea that stockholders own corporation); *infra* note 66 and accompanying text (discussing proprietary interest required for standing to bring derivative suits on corporation's behalf). *But see* McDaniel, *supra* note 6, at 149-50 (arguing that modern corporation is nexus of contracts and has no owners).

Professor Mitchell argues that the standing rules are the reason for the prevalence of the mistaken views that the purpose of the corporation is to generate profits for its shareholders and that the corporate directors' fiduciary duties run exclusively to the shareholders. Mitchell, *supra* note 1, at 606-07. According to Professor Mitchell, the directors of a corporation, at least theoretically, owe fiduciary duties to the corporation as a whole. *See id.* at 580-81 (characterizing idea that shareholders are exclusive beneficiaries of directors' fiduciary duties as notion that needs to be put to rest); *see also infra* note 101 (listing support for Chancellor Allen's statement that fiduciary duties of corporate directors run to entire corporate enterprise). Even so, the law only grants to the corporation's shareholders standing to bring derivative suits on behalf of the corporation for breach of those fiduciary duties. By enabling only a single group within the corporate enterprise to enforce the directors' duties, the law in effect creates the incentive for the corporate directors to act as though the shareholder's interests comprise the whole of the corporation's interests. Mitchell, *supra* note 1, at 606-07. Because

Courts therefore deny derivative standing to creditors of solvent corporations.[65] As justification for refusing creditors access to the derivative suit, courts generally hold either that creditors lack the requisite proprietary interest in the corporation[66] or that as nonowners, creditors lack the injury needed to confer standing.[67]

Oddly, even upon corporate insolvency, when courts recognize a directorial duty running to creditors,[68] these standing rules do not effectively yield.[69] Although a few courts have indicated that when the insolvency

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only the shareholders can wield the threat of litigation, directors, in the interest of avoiding litigation, are motivated to act as though they are answerable only to the shareholders. *Id.* Thus, Professor Mitchell asserts, the idea emerged under the traditional model of corporate governance that the shareholders *are* the corporation, and therefore that the fiduciary duties which corporate directors owe to the corporation actually run exclusively to the shareholders as a group. *Id.*; *see also infra* note 101 (observing that characterizing shareholder suits as "derivative" blatantly contradicts idea that directors owe fiduciary duties to shareholders rather than to corporation as a whole).

Because of the business judgment rule, the derivative suit is arguably an inadequate enforcement mechanism even for shareholders. *See supra* note 42 (explaining business judgment rule). Therefore, if other stakeholders ultimately get the benefit of standing to enforce the fiduciary duties, the business judgment rule will likely allow directors to quash their claims too. *See* Macey, *supra* note 12, at 24 (arguing that if because of nonshareholder corporate constituency statutes, nonshareholders gain some of shareholders' rights as beneficiaries of directorial fiduciary duties, shareholder loss would not be great because business judgment rule effectively protects most board actions from shareholder scrutiny anyway).

65. *See* Harff v. Kerkorian, 324 A.2d 215, 219 (Del. Ch. 1974) (explaining that debenture holders are creditors and therefore do not have standing because stockholder status is essential to the maintenance of derivative suit), *aff'd in part, rev'd in part on other grounds* (Del. 1975); Weinberger v. UOP, Inc., 1979 WL 2697, at *2 (Del. Ch. 1979) (holding that where by virtue of terms of merger, shareholder of now defunct corporation is converted into creditor of surviving corporation, shareholder no longer has standing to maintain derivative action on behalf of defunct corporation); Note, *Creditors' Derivative Suits on Behalf of Solvent Corporations*, 88 YALE L.J. 1299, 1300 (1979) (commenting that law generally does not allow creditors to maintain derivative suits while corporation is still solvent).

66. *See Kusner* 395 F. Supp. at 280-83 (holding that limitation of standing to persons with proprietary interest justifies barring creditors' suits); Brooks v. Weiser, 57 F.R.D. 491, 494 (S.D.N.Y. 1972) (reiterating "obvious" proposition that right to sue derivatively is attribute of ownership).

67. *See, e.g.*, Appleton v. American Malting Co., 54 A. 454, 456 (N.J. 1903) (reasoning that creditors can suffer no injury from illegal payment of dividends unless capital is so impaired as to render company insolvent); Frederick G. Kempin, Jr., *Enforcement of Management's Duties to Corporate Creditors*, 6 AM. BUS. L.J. 371, 377-78 (1968) (suggesting that creditors could never have requisite injury to confer standing to sue solvent corporation derivatively because if creditors are injured corporation must, by definition, be unable to pay its debts).

68. *See* Geyer v. Ingersoll Publications Co., Civ. A. No. 12406, 1992 WL 136743, at *3 (Del. Ch. June 18, 1992) (recognizing that upon corporate insolvency, creditors become beneficiaries of directors' fiduciary duties); Harff v. Kerkorian, 324 A.2d 215, 222 (Del. Ch. 1974) (explaining that insolvency is special circumstance that causes directors' duties to run to creditors), *aff'd in part, rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975).

69. *See supra* notes 64-66 and accompanying text (explaining that under traditional model, standing to sue directors on corporation's behalf is function of ownership and thus limited to shareholders). When insolvency occurs, the board owes fiduciary obligations to

exception applies, a creditor's derivative suit theoretically is appropriate,[70] no reported cases appear to exist in which a creditor of an insolvent corporation successfully has asserted standing to maintain a derivative suit to enforce directorial fiduciary duties. The procedural issue of creditors' derivative standing did not arise in *Geyer*.[71] In that case, the defendant moved to dismiss on the grounds that the Delaware Court of Chancery lacked personal jurisdiction over him because he was a resident of Connecticut.[72] The defendant argued that the statute under which the plaintiff purported to accomplish service of process upon him[73] limits service on nonresident directors to suits for breach of fiduciary duties.[74] The defendant further maintained that because directors' fiduciary duties do not run to corporate creditors unless the circumstances have triggered the insolvency exception, the service was invalid.[75] Thus, the narrow issue before the court in *Geyer* was not whether the plaintiff had standing to maintain a derivative suit, but rather whether the corporation had attained insolvency such that the board's fiduciary duties had begun to run to the corporation's creditors.[76]

III. Dissatisfaction with the Philosophical Underpinnings of the Traditional Model

Today, many corporate law scholars are coming to believe that the traditional model of corporate governance is an inadequate paradigm for the modern corporation.[77] To them, the image of the corporation as a mere

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creditors because insolvency transforms creditors into "owners." Brudney, *supra* note 54, at 1843 n.68. Therefore, the failure of the traditional standing rules to bend upon insolvency is odd in light of the traditional model's link between "ownership" of the corporation and standing to sue on its behalf.

70. *See* Ford Motor Credit Co. v. Minges, 473 F.2d 918, 920 (4th Cir. 1973) (holding that when director of insolvent corporation fraudulently or negligently causes injury to corporation and its creditors generally, creditor may maintain right of action on behalf of corporation); Eskimo Pie Corp. v. Whitelawn Dairies, Inc., 266 F. Supp. 79, 82 (S.D.N.Y. 1967) (requiring that when seeking standing to sue derivatively, creditor must show at least that debtor corporation is "notoriously insolvent"); *see also* Kempin, *supra* note 67, at 377-78 (arguing that unless corporation is insolvent, there can be no reason for creditors' derivative suit).

71. *Geyer*, 1992 WL 136743.

72. *Id.* at *2.

73. Del. Code Ann. tit. 10, § 3114 (Supp. 1990).

74. Geyer v. Ingersoll Publications Co., Civ. A. No. 12406, 1992 WL 136743, at *2 (Del. Ch. June 18, 1992).

75. *Id.*

76. *Id.* at *3.

77. *See supra* notes 1-2 and accompanying text (providing evidence of ideological change in corporate law); *see also Marketplace*, *supra* note 1 (quoting business writer Charles Handy, speaking on traditional corporate law). Mr. Handy stated,

> We may have mistaken a requirement for a purpose. The requirement is to make a profit, but to turn a requirement into a purpose is not right. We have to eat to live, but if you live to eat you become a distorted human being in more senses than one. We have to make a profit to survive, but that's not enough. What's the purpose

aggregate of profit-seeking shareholders simply is not reflective of the current corporation's actual place and pervasive influence in society.[78] They argue that in light of the significant effects of corporate decisionmaking on society as a whole, to treat a corporation as nothing more than a conglomeration of individual shareholders is to ignore the reality of the modern publicly held corporation.[79]

Critics of the traditional view maintain that because the modern corporation is such an important participant in our society, corporate directors should, during the decisionmaking process, consider a much wider array of interests than just those of the shareholders.[80] Thus, to some, it is far from obvious that the body of shareholders should be the singular beneficiary of the corporate board's fiduciary duties.[81] Because corporate directors are charged with managing the whole of the modern publicly held corporation,[82] the needs and interests of the "entire corporate enterprise" require the board's attention.[83] Under this emerging thinking, then, the corporation is a "community of interests," not limited to the shareholders' interests.[84]

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beyond the requirement?

Id.

Modern rejection of the shareholder-centered approach to corporate governance actually signals a return to early ideas about the corporation. *See* Millon, *supra* note 2, at 903-11 (explaining that in nineteenth century, corporation law had broader focus and reflected serious concerns about corporations' economic and political power; characterizing law's renewed interest in nonshareholder concerns as rebirth); Wallman, *supra* note 6, at 168 (indicating that nonshareholder corporate constituency statutes "bring director responsibility back to its roots by demanding that directors act in the best interests of the corporation"); *see also* McDaniel, *supra* note 6, at 151 (relating that "nineteenth century corporation law reflected a concern for other constituencies and contained statutory protections (however feeble) for nonshareholders, especially creditors and the general public"); Wallman, *supra* note 6, at 166-67 (explaining policy behind nineteenth century corporation law).

78. *See* Johnson, *Meaning of Corporate Life*, *supra* note 1, at 934 (arguing that "[f]or courts to embrace a radically proshareholder vision of corporate endeavor would be out of line with prevailing social norms, however soothing that outcome might be for corporate law's own peace of mind" and that "shareholder primacy does not ring true").

79. *See* Mitchell, *supra* note 1, at 584 (calling for corporate law to be more reflective of corporations' societal role).

80. *See* McDaniel, *supra* note 6, at 137-39 (arguing in favor of creation of dual goal for directors: maximizing shareholder gain and minimizing stakeholder loss); Wallman, *supra* note 6, at 189 (maintaining that shareholder-only model of *Revlon* mandates unfair transfers of wealth from nonshareholders to shareholders). *But see* F.A. Hayek, *Law, Legislation, Liberty*, *in* 3 THE POLITICAL ORDER OF A FREE PEOPLE 82 (1979) (expressing concern that without narrowly circumscribed class of beneficiaries, corporate directors would be too powerful); Minnow, *supra* note 4, at 218 (arguing that director fulfilling his duty to shareholders will inevitably consider other stakeholders' interests).

81. *See* Stone, *supra* note 4, at 45-69 (arguing that directors' fiduciary duties should run to employees); Mitchell, *supra* note 1, at 590 (arguing that directors' duties should be situation-specific).

82. *See* DEL. CODE ANN. tit. 8, § 141(a) (1991).

83. *See infra* note 101 (showing that view that board owes duties to corporation itself is not new).

84. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL

Disapproval of the traditional, shareholder-centered portrait of the corporation and adherence to the newer "community of interests" or "corporate enterprise" concept have caused both legislative and judicial change.[85]

A. *Legislative Manifestations of the Dissatisfaction: Nonshareholder Corporate Constituency Statutes*

The most striking examples of reformation attributable to the new concern for nonshareholder members of the corporate enterprise are the nonshareholder constituency statutes that the legislatures of twenty-eight states have enacted.[86] All but one of the statutes allow but do not require directors making decisions on behalf of a corporation to consider the interests of corporate constituencies other than the shareholders.[87] For purposes of the statutes, nonshareholder constituencies, otherwise known as stakeholders, typically include the corporation's creditors, employees, suppliers, community, and others.[88]

B. *Judicial Manifestations of the Dissatisfaction: The Trend in the Common Law of Delaware*

The Delaware legislature[89] has not passed a nonshareholder constituency statute, but opinions of the state's courts provide proof that the philosophical re-examination of the corporate role in society is happening in that

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277613, at *36 (Del. Ch. Dec. 30, 1991) (requiring directors of nearly insolvent corporations to consider "community of interest" in making business decisions on corporation's behalf). Under the view that directors owe their fiduciary duties to the entire corporate enterprise, it makes sense to say that a shareholder must bring suit against directors "on behalf of the corporation" or as if she were "standing in the shoes of the corporation." *See infra* note 101 (arguing that if class of shareholders is direct beneficiary of directorial duties, right of class to sue directors for breaching fiduciary duties should not be characterized as derived from corporation as a whole). Thus, under the idea of a corporate enterprise, the shareholder's derivative suit is less of a misnomer than it is under the traditional model. *Id.*

85. *See infra* notes 86-108 and accompanying text (describing nonshareholder corporate constituency statutes and Delaware decisions that endorse corporate enterprise idea).

86. *See* Mitchell, *supra* note 1, at 610 (calling nonshareholder constituency statutes "the most obvious feature of the reordering of the corporate legal landscape"); Stone, *supra* note 4, at 47 (explaining that statutes represent departure from conventional law wisdom that directors' sole duty is to shareholders); *supra* note 9 (listing 28 nonshareholder corporate constituency statutes); *see also* McDaniel, supra note 6, at 151-52 (noting that several state legislatures enacted nonshareholder constituency statutes specifically in reaction to Delaware Supreme Court's announcement of absolute shareholder primacy in *Revlon*).

87. *See* CONN. GEN. STAT. ANN. §33-313(e) (West Supp. 1991) (requiring directors to consider interests of nonshareholder constituencies including "community and societal considerations"); *see also* Hanks, *supra* note 9, at 103-04 (discussing Connecticut's statute).

88. Stone, *supra* note 4, at 45. Groups whose interests directors' actions affect are also commonly known as "stakeholders." Minnow, *supra* note 4, at 218.

89. Because of adherence to the view that Delaware law is "our national corporate law," examination of the trend in Delaware corporations law is necessary. Branson, *supra* note 25, at 87.

state as well.[90] Notwithstanding the holdings in *Revlon* and *Katz*, in a string of recent cases, Delaware courts have displayed a growing acceptance of the notion that the corporation is a "corporate enterprise" encompassing the interests of several groups, shareholders and nonshareholders alike.[91] Rehabilitating the corporate enterprise idea that Professor E. Merrick Dodd of Harvard Law School announced more than sixty years ago in his famous debate with Professor Adolph A. Berle of Columbia Law School,[92] Delaware's courts have made incremental advances towards effectively confronting the tension that certain situations create among corporate constituencies.[93] The landmark case of *Paramount Communications, Inc. v. Time, Inc.*[94] was the Delaware courts' first major move toward reviving Professor Dodd's corporate enterprise model.[95] Undercutting the validity of the absolute

90. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1989) (holding that aside from short-term shareholder gain, long-term preservation of "Time culture" is corporate interest board may consider when evaluating takeover threat); Unocal Corp. v. Mesa Corp., 493 A.2d 946, 955 (Del. 1985) (suggesting that in board decision whether to defend against takeover attempt, interests of entire corporate enterprise, not just shareholders, are at stake); Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991) (indicating that directors should consider "entire corporate enterprise" in decisionmaking process); *see also* Johnson, *Meaning of Corporate Life*, *supra* note 1, at 933-36 (1990) (indicating that Delaware judiciary is grappling with fundamental questions of corporate nature and purpose); McDaniel, *supra* note 6, at 152 n.110 (commenting that courts of Delaware are beginning to recognize that corporate boards should be able to consider nonshareholder constituencies in variety of circumstances).

91. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1989) (holding that aside from short-term shareholder gain, long-term preservation of "Time culture" is corporate interest board may consider when evaluating takeover threat); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that in context of takeover, in order for director action to fall within protection of business judgment rule, directors must analyze nature of takeover bid and its effect on corporate enterprise, including impact on nonshareholder constituencies); *Credit Lyonnais*, 1991 WL 277613, at *36 n.55 (indicating that directors should consider "entire corporate enterprise" in decisionmaking process); Johnson, *Sovereignty*, *supra* note 1, at 2245 n.148 (arguing that term "enterprise" should be more prominent in corporate law because it "carries an original meaning of energy and activity in an undertaking, and a more recent connotation of associative endeavor").

92. *See* Berle, *supra* note 35, at 1367-68 (arguing that practically speaking, law cannot abandon emphasis on shareholder profit as corporate purpose); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1145-46, 1153-54 (1932) (putting forth corporate enterprise concept; arguing that corporations have responsibilities to their communities); *see also* Hanks, *supra* note 9, at 97-98 (tracing corporate enterprise theory forward from Berle-Dodd debate to present).

93. *See Time*, 571 A.2d at 1152 (holding that aside from short-term shareholder gain, long-term preservation of "Time culture" is corporate interest board may consider when evaluating takeover threat); *Unocal*, 493 A.2d at 955 (suggesting that in board decision whether to defend against takeover attempt, interests of entire corporate enterprise, not just shareholders, are at stake); *Credit Lyonnais*, 1991 WL 277613, at *34 (indicating that directors should consider entire corporate enterprise in decisionmaking process).

94. 571 A.2d 1140 (Del. 1989).

95. Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989); *see supra* note 92 and accompanying text (attributing corporate enterprise idea to Professor Dodd).

shareholder primacy principle of *Revlon*,[96] the Delaware Supreme Court in *Time* viewed the corporation as an entity distinct from the shareholders.[97]

The latest development, footnote fifty-five of *Credit Lyonnais*, builds on *Time*'s premise and is potentially much more powerful.[98] In what one distinguished member of the Delaware Bar called the "footnote of the year," Chancellor Allen made the big leap from stating that sometimes directors *may* consider other stakeholders' interests to asserting that the board *should* consider other stakeholders' interests in certain situations.[99] Reopening several seemingly settled questions of Delaware's corporations law,[100] Chancellor Allen indicated that when a not-yet-insolvent corporation is operating "in the vicinity of insolvency," the board of directors owes fiduciary duties not to the shareholders exclusively, but to the entire corporate enterprise.[101]

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96. *See* Lyman Johnson & David Millon, *The Case Beyond Time*, 45 BUS. LAW. 2105, 2110-12, 2117-20 (1990) (describing how *Time* decision narrowed *Revlon*'s applicability by treating it as special case); Wallman, *supra* note 6, at 166 n.10 (pointing out that because of *Time*, *Revlon* has "limited vitality").

97. *See* Johnson & Millon, *supra* note 96, at 2108-09 (noting that *Time* court recognized that director action in best interests of corporation can be contrary to shareholders' profit-maximizing interests).

98. Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991).

99. *See id.* at *36 (indicating what directors in footnote's hypothetical *should* do; indicating which course of action would be "right"—i.e., both efficient and fair); *see also Footnote of the Year*, *supra* note 25, at 388 (quoting A. Gilchrist Sparks III of Morris, Nichols, Arsht & Tunnell in Wilmington, Delaware, who called *Credit Lyonnais*'s footnote 55 "footnote of the year"); *cf. Time* 571 A.2d at 1152 (holding that board may take corporate interests other than those of shareholders into account in making business decision); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that directors may consider impact of decision on nonshareholder constituencies).

100. *See* Mills Acquisition Co. v. McMillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) (holding that directors owe fiduciary duties to corporation and its shareholders); Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (same); Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (same); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (same); Katz v. Oak Indus., 508 A.2d 873, 879 (Del. Ch. 1986) (making clear that creditors are not beneficiaries of directors' fiduciary duties); *supra* notes 63-67 and accompanying text (indicating that traditional model allows only shareholders to bring derivative suits on corporation's behalf).

101. *Credit Lyonnais*, 1991 WL 277613, at *36 n.55; *see also* Varallo & Finkelstein, *supra* note 17, at 241 (recounting that in footnote 55, Chancellor Allen created directorial fiduciary "duties" to nonshareholder members of corporate enterprise on verge of insolvency).

A. Gilchrist Sparks III considers Chancellor Allen's reasoning in footnote 55 a clever way of sidestepping the case law because the Chancellor starts with the principle that directors owe duties not only to the shareholders but to the corporation itself. *Footnote of the Year*, *supra* note 25, at 388. Given that starting point, the Chancellor's holding—that directors may not take actions which when viewed from a risk-adjusted basis, would harm the corporation even if the action would be desirable from the standpoint of the shareholders—seems natural. *Id.*

But the Chancellor's holding that the board's fiduciary duties run to the corporation as a whole is not without support. *See* Pepper v. Litton, 308 U.S. 295, 307 (1939) (holding that

In footnote fifty-five, Chancellor Allen provided a hypothetical situation to demonstrate the various corporate constituencies' legitimate and competing interests that inevitably become increasingly prevalent as a corporation nears insolvency.[102] Next, he pointed out that the director of an almost insolvent corporation who concerns himself only with the interests of the shareholders will not always reach the "right" result.[103] It is instead the director who considers the interests of the range of constituencies that together comprise the "corporation as a legal and economic entity" that will accomplish the desirable end of fair and efficient corporate governance.[104] The footnote reads, in part:

> [I]n managing the corporate affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.[105]

When contrasted with the language and sentiment of *Revlon*[106] and *Katz*,[107] both of which are typical of the traditional approach to the duties of

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directors are fiduciaries only of corporation itself); Schautteet v. Chester State Bank, 707 F. Supp. 885, 888-89 (E.D. Tex. 1988) (holding that fiduciary obligations protect entire community of interests in corporation); Enterra Corp. v. SGS Assocs., 600 F. Supp. 678, 684 (D.C. Pa. 1985) (holding that directors stand in fiduciary relation to corporation); Underwood v. Stafford, 155 S.E.2d 211, 212 (N.C. 1967) (holding that in North Carolina, boards occupy fiduciary position with regard to shareholders *and* creditors) ; Goodwin v. Whitener, 138 S.E.2d 232 (N.C. 1964) (holding that fiduciary duties are owed to corporation); *see also* John C. Carter, *The Rights of Other Corporate Constituencies*, 22 MEM. ST. U. L. REV. 491, 493-94 (1992) (arguing that case law holding that directors owe direct duties to shareholders is "virtually nonexistent"); Wyatt R. Haskell, *The Relationship of Directors of a Close Corporation to Its Creditors*, 1 CUMB. L. REV. 209, 209 (1970) (recounting "accepted legal theory" that directors owe direct duties to corporation itself and only derivative ones to shareholders); Mitchell, *supra* note 1, at 580-81 (characterizing idea that shareholders are exclusive beneficiaries of directors' fiduciary duties as notion that needs to be put to rest); Wallman, *supra* note 6, at 166 n.11 (relating that under early corporation jurisprudence, directors' sole duty was to corporation).

Moreover, the fact that shareholders as a class cannot, in their own right, sue the directors when the directors breach the fiduciary duties implies that the directors do not owe their fiduciary duties to the shareholders. *See* Niles v. New York Cent. & H. R.R., 68 N.E. 142, 144 (Del. 1903) (holding that absent direct fraudulent transaction between director and shareholder, shareholder can maintain suit against director only derivatively, based on injury to corporation). In other words, if the directors owe fiduciary duties to the shareholders as a collective unit, why must the shareholders bring suits "on behalf of the corporation"? *Id.*

102. *Credit Lyonnais*, 1991 WL 277613, at *36 n.55.

103. *Id.*

104. *Id.*

105. *Id.*

106. *See* Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) (holding that director action based on concern for nonshareholders is only appropriate when

directors and the rights of creditors of solvent corporations, footnote fifty-five does indeed appear to signal a significant departure.[108]

IV. Assessment of the Judicial and Legislative Efforts

A. Comparison of the Substantive Features and Flaws of the Reform Efforts

To date, neither judicial nor legislative efforts adequately address the problem of the lack of director attention to the interests of nonshareholder constituencies in the corporate decisionmaking process.[109] Relatively speaking, however, the judicial trend in Delaware is more promising as a start down an avenue of real change.[110]

Ironically, by all but eliminating directorial accountability, the well-intended nonshareholder corporate constituency statutes worsen the situation facing all members of the corporate body.[111] Carefully cast in permissive

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that action will yield some rationally related benefit to stockholders); *supra* notes 44-47 and accompanying text (discussing *Revlon* holding).

107. *See* Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (stating that "[i]t is the obligation of the directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders . . . It seems likely that corporate restructurings designed to maximize shareholder values may in some instances have the effect of requiring [creditors] to bear greater risk of loss and thus in effect transfer economic value from bondholders to stockholders"); *supra* notes 48-53 and accompanying text (discussing *Katz*).

108. *See Footnote of the Year*, *supra* note 25, at 388 (reporting that footnote 55 "appears to signal a deviation from well-settled Delaware principles"); Winnike, *supra* note 27 (noting that in *Katz* and *Revlon*, Delaware courts had forcefully rejected assertions that *Credit Lyonnais*'s footnote 55 accepts). *But see* Varallo & Finkelstein, *supra* note 17, at 242 n.12 (indicating that *Katz* and *Credit Lyonnais* are not necessarily inconsistent).

109. *See infra* notes 111-18 and accompanying text (detailing theoretical weaknesses of nonshareholder corporate constituency statutes); *infra* note 120 and accompanying text (describing limited scope of pre-*Credit Lyonnais* Delaware common law's progress on creating incentives for directors to address nonshareholder needs); *infra* notes 143-63 and accompanying text (arguing that statutes and Delaware common-law advances—including *Credit Lyonnais*—are ineffective because they lack nonshareholder enforcement mechanisms). *But see* Stone, *supra* note 4, at 71 (stating that enactment of nonshareholder corporate constituency statutes is important, even for its value as signal that nonshareholder interests deserve serious public attention).

110. *See infra* notes 119-42 and accompanying text (pointing out differences between *Credit Lyonnais* and statutes). One scholar maintains that in enacting the statutes, state legislatures expected that courts would use the common law to supplement them and make them more effective. *See* McDaniel, *supra* note 6, at 126 & n.19 (arguing that nonshareholder corporate constituency statutes require judicial interpretation and development and that "[c]orporate constituency statutes are not necessary for the development of a corporate common law that enables directors to consider and protect stakeholder interests").

111. *See* William J. Carney, *Does Defining Constituencies Matter?*, 59 U. Cin. L. Rev. 385, 418 (1990) (maintaining that nonshareholder constituency statutes hinder corporate law's goal of making directors accountable); Macey, *supra* note 12, at 32-33 (arguing that because statutes are typically permissive and without exception unenforceable, they render directors free of accountability for their actions). *But see* Wallman, *supra* note 6, at 188 (arguing that nonshareholder constituency statutes "do not purport to provide nonshareholder constituents with 'enhanced legal protections,' but instead require the directors to focus on and act in the best interests of the corporation").

language, the vast majority of these statutes[112] leave the board free to consider or not to consider the interests of any or all of the corporate constituencies.[113] The statutes grant the board "standardless discretion"[114] because virtually any action the board might take, it could justify after-the-fact as having served the interests of some member of the corporate enterprise.[115]

Moreover, even assuming that corporate directors would not see these statutes as invitations to serve their own interests, the statutes provide the board with virtually no guidance in determining when and how to give adequate attention to each of the corporate interests the statutes recognize as legitimate.[116] For that reason, one commentator asserts that nonshareholder corporate constituency statutes create "too many masters" for the corporate board to serve.[117] As Professor Lawrence Mitchell similarly ex-

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112. *But see* CONN. GEN. STAT. ANN. § 33-313(e) (West Supp. 1991) (requiring directors to consider interests of nonshareholder constituencies including "community and societal considerations").

113. *But see* McDaniel, *supra* note 6, at 126 (arguing that by being imprecise, nonshareholder corporate constituency statutes direct courts to develop standards and supply particulars); Wallman, supra note 6, at 165-66 (contending that directors must justify their actions as being in corporation's best interests, not those of any single constituency).

114. James J. Hanks, Jr., *Non-Stockholder Constituency Statutes: An Idea Whose Time Should Never Have Come*, INSIGHTS, Dec. 1989, at 20, 24-25. *But see* McDaniel, *supra* note 6, at 160 (arguing that courts will create standards through evolution of corporate common law).

115. *See* Macey, *supra* note 12, at 32-33 (contending that nonshareholder corporate constituency statutes make directors' jobs easier because "virtually *any* management decision, no matter how arbitrary, can be rationalized on the grounds that it benefits *some* constituency of the corporation); *see also* F.A. Hayek, *Law, Legislation, Liberty, in* 3 THE POLITICAL ORDER OF A FREE PEOPLE 82 (1979) (expressing concern that without narrowly circumscribed class of beneficiaries of directors' fiduciary duties, corporate directors would be too powerful). *But see* McDaniel, *supra* note 6, at 137-39 (arguing that creation of dual goal for directors—increasing shareholder gain and decreasing stakeholder loss—would not do away with accountability because "[n]either variable is vague; both can be quantified and monitored"); Wallman, *supra* note 6, at 165-66 (contending that because nonshareholder constituency statutes require director action "in the best interests of the *corporation*," they do not reduce board accountability; directors must act in interest of entire corporation and cannot justify their actions as benefitting only one group) (emphasis added).

116. *See* Hanks, *supra* note 9, at 113-15 (arguing that nonshareholder corporate constituency statutes lack standards for directors to use in protecting shareholder and nonshareholder interests); *see also* Brudney, *supra* note 54, at 1837 n.49 (arguing that because of conflicts of interest between stockholders and bondholders, management cannot occupy fiduciary relationship to both).

117. Macey, *supra* note 12, at 31. Though he agrees with the "too many masters" argument, Professor Macey thinks that some scholars overstate it. *Id.* at 33. If the problem of directors having too many masters is so intractable, then why, Professor Macey asks, are corporate directors able to discharge their fiduciary duties to shareholders with varying classes of stock even though the different classmembers' interests sometimes conflict. *Id.*; *see also* McDaniel, *Stockholders and Stakeholders*, *supra* note 6, at 158 (arguing that neither law nor fact supports proposition that directors can be agents of only one constituency; rejecting argument that "manager responsible to two conflicting interests is in fact accountable to neither") (quoting Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1192 (1981).

plained, the statutes raise "the spectre . . . of a board of directors blindly groping to balance the conflicting interests of a variety of constituent groups without any means of measuring the interests required to be considered or of assessing the relative priorities of such interests."[118]

Compared to the nonshareholder corporate constituency statutes, the doctrinal development taking place in Delaware's common law is more encouraging, especially the latest breakthrough that footnote fifty-five of *Credit Lyonnais* represents.[119] Whereas *Time* and other recent Delaware opinions, like the nonshareholder corporate constituency statutes, merely broadened the scope of directorial discretion,[120] *Credit Lyonnais*'s footnote fifty-five did more.[121] With footnote fifty-five, Chancellor Allen seems to have created duties for directors, rather than just the option to consider the interests of nonshareholders.[122]

Recognizing that the exigencies of running a corporation do not remain stagnant over the span of corporate life, footnote fifty-five takes an elastic approach to the question of directorial fiduciary duties.[123] Unlike the traditional model, footnote fifty-five does not adopt the stance that shareholders are the exclusive beneficiaries of the board's fiduciary duties.[124] Nor did Chancellor Allen appear in footnote fifty-five to espouse the nonshareholder constituency statutes' view that a board may simply *choose* to concern itself with the needs of any or all of the corporate constituencies in making a decision.[125] Instead, footnote fifty-five requires directors to be sensitive to the corporation's factual circumstances which can cause the interests of one

118. Mitchell, *supra* note 1, at 589.

119. *See infra* notes 120-27 and accompanying text (describing theoretically effective, intermediate approach *Credit Lyonnais*'s footnote 55 takes between traditional model and nonshareholder corporate constituency statutes).

120. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1989) (indicating that board may consider corporate interests other than shareholders' in making business decision on corporation's behalf); Unocal Corp. v. Mesa Corp., 493 A.2d 946, 955 (Del. 1985) (holding that board *may* consider nonshareholder constituencies' interests in certain contexts); *see also* Johnson & Millon, *supra* note 96, at 2108 (describing "troubling" accountability problem *Time* decision creates and noting that *Time* provides directors no guidance for acting in corporation's best interests); Wallman, *supra* note 6, at 172 (observing that *Time*'s approach is similar to that of nonshareholder corporate constituency statutes).

121. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 (Del. Ch. Dec. 30, 1991) (indicating what directors in footnote's hypothetical *should* do; indicating which course of action would be "right"—i.e., both efficient and fair).

122. *Id.*; *see* Varallo & Finkelstein, *supra* note 17, at 241-43 (detailing duties Chancellor Allen created in footnote 55).

123. *See Credit Lyonnais*, 1991 WL 277613, at *36 n.55 (indicating that corporate circumstances are quite relevant in determination of whose interests board decisions must seek to shield).

124. *See supra* notes 40-47 (describing traditional model's shareholder-centered approach to defining directorial fiduciary duties).

125. *See supra* notes 111-15 and *infra* notes 149-56 and accompanying text (describing how permissive and unenforceable attributes of nonshareholder corporate constituency statutes free directors of accountability for decisionmaking).

or more constituencies to be unusually vulnerable in a given context.[126] By directing the board to act upon such corporate particulars in the discharge of its fiduciary duties to the corporation, the footnote takes an effective, intermediate position between the two extremes of the traditional model and the nonshareholder corporate constituency statutes.[127] Chancellor Allen did not, however, delineate the scope of applicability he intended footnote fifty-five's more flexible approach to have.[128] While it is apparent that the footnote's reasoning works to the benefit of creditors of corporations nearing insolvency,[129] it is less obvious whether the Chancellor meant to invite any extensions of the reasoning such that other stakeholders may sometimes take advantage of the ideas in the footnote as well.[130]

If nothing else, footnote fifty-five makes the important contribution of improving upon the ideas underlying the traditional model's insolvency exception.[131] Recognizing the unique circumstances of corporations on the verge of insolvency, Chancellor Allen,in footnote fifty-five, called for differential treatment of such corporations from other solvent corporations.[132] He demonstrated that *Geyer*'s test of insolvency-in-fact[133] is inadequate as

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126. Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991) (identifying board duties by first assessing corporate circumstances: "*At least where a corporation is operating in the vicinity of insolvency*, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise") (emphasis added); *see also* McDaniel, *supra* note 6, at 146-47 (maintaining that while stakeholder statutes presently confer no legally enforceable rights, perhaps courts will later "recognize that directors owe enforceable duties to *some stakeholders in some cases, particularly primary stakeholders when they are being expropriated*") (emphasis added). *See generally* Mitchell, *supra* note 1, at 590 (arguing in favor of situation-specific directorial fiduciary duties).

127. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*).

128. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*).

129. *See* Winnike, *supra* note 27 (stating that *Credit Lyonnais*'s footnote 55 expands range of situations in which directors are fiduciaries of creditors).

130. *See supra* note 18 (quoting footnote 55 of *Credit Lyonnais*).

131. *See* Winnike, *supra* note 27 (pointing out that *Credit Lyonnais* "may be read as expanding the range of situations in which a financially troubled company's directors become fiduciaries for its creditors"); *supra* notes 54-62 and accompanying text (describing traditional model's insolvency exception to general rule that board owes no extra-contractual duties to corporate creditors). *But see* New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 110 N.E.2d 397, 398 (N.Y. 1953) (holding that though corporation was technically solvent, because insolvency was "only a few days away," directors were creditors' trustees); Brudney, *supra* note 54, at 1843 n.68 (citing *Credit Lyonnais*'s footnote 55 as support for proposition that insolvency exception is problematic in practice); Varallo & Finkelstein, *supra* note 17, at 243 (asserting that even without *Credit Lyonnais*'s footnote 55, something short of insolvency might cause trust for benefit of creditors to arise).

132. The debate footnote 55 of *Credit Lyonnais* has engendered centers on those corporations which, though technically solvent, are operating on shaky grounds. *Footnote of the Year*, *supra* note 25, at 388.

133. *See* Geyer v. Ingersoll Publications, Civ. A. No. 12406, 1992 WL 136743 (Del. Ch. June 18, 1992) (holding that insolvency exception to general rule that board owes no fiduciary duties to corporate creditors attaches at moment of insolvency-in-fact rather than at institution of statutory proceedings).

the temporal indicator of the need for a shift in the fiduciary duties of corporate directors from the shareholders to the creditors.[134] Because avoidance of insolvency is usually a goal of creditors, the moment that a corporation becomes insolvent-in-fact is too late for the directors' duties to creditors to arise.[135] In other words, according to Chancellor Allen, the turning point from solvency to insolvency comes too late to be the relevant event signalling the requirement of a shift in corporate directors' attention.[136]

Illuminating the unique predicament of creditors of an almost insolvent corporation may not have been the only goal of *Credit Lyonnais*'s footnote fifty-five. Perhaps Chancellor Allen used the near-insolvency scenario as an example to make the broader point that the identity of the beneficiaries of directorial duties should vary in connection with the subject of the decision facing the board.[137] The Chancellor clearly did put forth the important assertion that directors *should* consider the corporate community of interests when acting on behalf of the corporation.[138] Moreover, Chancellor Allen emphasized that the corporation's condition should dictate how the board will translate its consideration of the various corporate constituencies into action.[139]

Through the hypothetical situation of almost-insolvency that Chancellor Allen posited in footnote fifty-five, he provided an example of a time in the corporate life when the interests of the corporate creditors deserve special attention.[140] In calling for a shift in the board's fiduciary duties when the corporation is financially troubled, the Chancellor opened the door to the argument that there are other situations in which the board's fiduciary duties should shift and accrue to the benefit of other specific nonshareholder groups.[141] Thus, one can use footnote fifty-five to contend that the issue of which particular stakeholders' interests are of primary concern—and therefore which interests the board should take extra pains to shield—will depend on the circumstances.[142]

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134. Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991).

135. *See id.* (requiring directors to consider creditors' interests when corporation is technically solvent, but "in the vicinity of insolvency").

136. *Id.*; *see also supra* notes 63-70 and accompanying text (discussing insolvency exception to general rule that board owes no fiduciary duties to corporate creditors).

137. *See generally* Mitchell, *supra* note 1, at 590 (arguing in favor of creation of circumstance-specific fiduciary duties on part of corporate boards).

138. *See Credit Lyonnais*, 1991 WL 277613, at *36 n.55 (stating that directors should consider "community of interests" in making decisions for corporation).

139. *See id.* (indicating that consideration of community of interests dictates what action board should take). The duty of care, as it is typically formulated, contains an indication that what is required of directors should vary with the circumstances. *See* REVISED MODEL BUS. CORPS. ACT § 8.30(a)(2) (requiring director to exercise care that ordinary prudent person in like position would exercise *under similar circumstances*).

140. *Credit Lyonnais*, 1991 WL 277613, at *36 n.55.

141. *Id.*

142. *Id.*

B. *Procedural Problems: Rights Without Remedies?*

Both the nonshareholder constituency statutes and the common-law developments in Delaware represent important theoretical challenges to the traditional model of corporate governance, but neither addresses the traditional model's rule limiting to the corporate shareholders the ability to sue the board on behalf of the corporation.[143] Indeed, recognition of the need for an enforcement mechanism for the theoretical change is unusually sparse in the contemporary attack on the traditional model.[144]

To the extent that the interests of the nonshareholder constituencies coincide with the interests of the shareholders, the traditional scheme is effective in protecting the entire corporation.[145] When a board violates its fiduciary duties, injuring a nonshareholder group, as long as the directors' action also injures the shareholders, the wrong can be redressed, because the shareholders can sue on behalf of the corporation.[146] If, however, the directors' action actually benefits the shareholders at the *expense* of the nonshareholder group,[147] the nonshareholders have no recourse under traditional corporate theory.[148]

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143. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991) (failing to address enforcement question); *infra* notes 149-50 and accompanying text (discussing statutes' refusal to grant means of enforcement to nonshareholders); *see also Footnote of the Year, supra* note 25, at 388-89 (noting absence of discussion of enforcement mechanism in footnote 55).

144. *But see* Hanks, *supra* note 9, at 116-17 (noting confusion nonshareholder constituency statutes produce on standing question); Stone, *supra* note 4, at 71 (advocating that courts develop a stakeholders' derivative action).

145. *See* Macey, *supra* note 12, at 34-35 (pointing out that over broad range of issues, shareholders' interests and nonshareholders' interests do not conflict). Professor Mitchell uses the term "vertical conflict" to refer to situations where conflict exists between the interests of the powerful director and the interests of one or more of the considerably less powerful corporate constituencies. Mitchell, *supra* note 1, at 591.

The classic example of an interest all corporate constituencies share is the prevention of directorial self-dealing. *Id.* When in the interest of seeking to avoid directorial self-dealing, the law imposes fiduciary duties on directors, the law is providing that when in the decision-making process, a director is faced with a vertical conflict of interest, he cannot make the choice that advances his own interests at the expense of the corporate constituencies. *Id.*; *see also* Pepper v. Litton, 308 U.S. 295, 306-07 (1939) (indicating that purpose of imposition of directorial fiduciary duties is more to prevent director misconduct than to protect beneficiaries of the duties); Kanda, *supra* note 52, at 441 n.30 (stating that corporate directors' fiduciary duties are "legal apparatus to deter abuse of managerial discretion"). 1

146. *See supra* notes 63-64 and accompanying text (discussing traditional law's limit on standing to sue board derivatively for injury to corporation).

147. *See, e.g.*, Credit Lyonnais v. Pathe Communications, Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991) (examining shareholders' and creditors' differing risk incentives when corporation is on verge of insolvency); John C. Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 Geo. L.J. 1495, 1498 (1990) (indicating that in takeover context, shareholder gains come at creditors' and employees' expense); Stone, *supra* note 4, at 71 (arguing that while management's defending against hostile takeover benefits shareholders, it hurts employees).

When the board acts in the interests of the shareholder, to the exclusion of the interests

Nonshareholder corporate constituency statutes typically are silent on the question of whether the stakeholders, whose interests the statutes seek to advance, may sue the directors for violating the statutes' provisions.[149] In fact, Pennsylvania's legislature addressed the question of enforcement by including in the state's statute an express denial of standing to nonshareholders.[150] Because the statutes include no enforcement mechanism in favor of their supposed protectees, they are woefully inadequate at offering even mild protection for stakeholder interests.[151] This inadequacy frustrates both the classic goal of the fiduciary duties under the traditional model—preventing directorial self-dealing[152]—and the statutes' newer, but equally important goal of preventing directors from inappropriately favoring shareholders at the expense of other constituencies.[153]

It is in part because of their failure to include an enforcement tool that the nonshareholder corporate constituency statutes accomplish a grant of greater latitude to the corporate directorate.[154] Former Commissioner of the Securities Exchange Commission (SEC) Joseph Grundfest recognized this

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of other constituencies, it chooses among the conflicting interests which exist *among* subordinate groups rather than between the board and one or more subordinate group(s). Mitchell, *supra* note 1, at 592. Professor Mitchell has termed a conflict of interests among constituent groups a "horizontal conflict". *Id.* at 591. As the traditional law stands, directors are to favor the shareholder in all such situations. *Id.* at 594.

148. *See infra* notes 63-67 and accompanying text (setting out traditional model's rule granting only shareholders standing to sue directors on corporation's behalf).

149. *See* Hanks, *supra* note 9, at 117 (noting that most nonshareholder corporate constituency statutes do not address question of enforcement).

150. *See* 15 PA. CONS. STAT. § 1717 (1991). Section 1717 states:

> The duty of the board of directors . . . may be enforced directly by the corporation or may be enforced by a shareholder, as such, by an action in the right of the corporation, and may not be enforced directly by a shareholder or by any other person or group. Notwithstanding the previous sentence, sections 1715(a) and (b) (relating to the exercise of powers generally) and section 1716(a) (relating to alternative standard) do not impose upon the board of directors, committees of the board and individual directors any legal or equitable duties, obligation or liabilities or create any right or cause of action against, or basis for standing to sue, the board of directors, committees of the board and individual directors.

Id.

151. *But see* Wallman, *supra* note 6, at 188-89 (pointing out that nonshareholder constituency statutes do not aim to create legal structure under which directors owe fiduciary duties to constituencies themselves, but rather to entire corporation; arguing that because statutes do not intend to give constituencies "direct voice in corporate governance," enforceability is unnecessary).

152. *See* Pepper v. Litton, 308 U.S. 295, 306-07 (1939) (holding that prevention of directorial self-dealing is reason for making directors fiduciaries); *see also* Mitchell, *supra* note 1, at 591 (explaining that vertical conflicts are the reason for the imposition of fiduciary duties on corporate directors); *supra* note 145 (explaining what Professor Mitchell means by "vertical conflict").

153. *See supra* note 147 (discussing horizontal conflicts).

154. *See* Mitchell, *supra* note 1, at 580 (citing concerns of Commissioner of Securities Exchange Commission and ABA Business Law Section that constituency statutes grant authority without accountability and create potential for directorial mischief).

fundamental flaw in the view that permissive nonshareholder corporate constituency statutes advance or protect the interests of the other corporate stakeholders.[155] In a 1989 letter to New York Governor, Mario Cuomo, he remarked that such statutes leave the nonshareholder corporate constituencies "powerless to monitor or challenge the actions that are purportedly taken in their interest."[156]

Similarly, by not providing for nonshareholder enforcement of the duties it recognizes, *Credit Lyonnais*'s footnote fifty-five limits its own impact as an advance in the corporate law.[157] Whether Chancellor Allen's design in writing footnote fifty-five was to affect only creditors of almost-insolvent corporations or to benefit other corporate constituencies in other circumstances, the absence of an enforcement mechanism in the footnote undermines the power of the innovative ideas it contains. Without teeth, the duties Chancellor Allen recognized in footnote fifty-five—however broad or narrow he intended them to be—will have no effect on the actual dynamics of the modern corporation.[158]

To corporate creditors footnote fifty-five certainly does represent a theoretical victory over the traditional law's rule that denies creditors beneficiary status with regard to directors' fiduciary duties.[159] Nonetheless, because the footnote excludes mention of what, if any, enforcement mechanism will be at the creditors' disposal while the corporation lingers "in the vicinity of insolvency," it offers only artificial protection for the creditors' interests.[160] Moreover, unless accompanied by the threat of litigation, application of the logic of footnote fifty-five to proclaim the importance of other stakeholders' interests in other situations will be an impotent means of affecting director behavior.[161] As Professor Mitchell argues, one of the main motivations of corporate directors is the avoidance of liability.[162] If in the theoretical world, directors' duties shift as the corporate circumstances change, but in the real world, only the shareholders

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155. *See id.* (quoting from letter from Joseph Grundfest, Securities and Exchange Commissioner to Mario Cuomo, governor of New York on June 6, 1989).

156. *Id.*

157. *See* Credit Lyonnais v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *36 n.55 (Del. Ch. Dec. 30, 1991).

158. *See* Mitchell, *supra* note 1, at 606-07 (arguing that in practical sense standing comes first, duty second); *supra* note 64 (explaining Professor Mitchell's argument).

159. *See supra* notes 131-36 and accompanying text (illustrating how Chancellor Allen, through footnote 55, improved upon traditional model's insolvency exception to general rule that board owes no extra-contractual duties to creditors).

160. *See Footnote of the Year, supra* note 25 at 388-89 (speculating about what sort of creditors' action, if any, footnote 55 implicates). According to A. Gilchrist Sparks III, an action based on footnote 55 would be a derivative action. *Id.* He suggested that one could use footnote 55's 'corporate enterprise' concept to argue for allowing nonshareholder constituencies to bring something akin to a derivative suit. *Id.*

161. *See supra* note 101 (outlining Professor Mitchell's theory that directors will protect interests of those who can sue them if they do not).

162. *See supra* note 101 (outlining Professor Mitchell's theory that directors will protect interests of those who can sue them if they do not).

can sue the directors for breach, the footnote's new recognition of nonshareholder interests will not fulfill its promise of change in board incentives.[163]

V. Conclusion

The tendency of the traditional model of corporate governance to equate the corporation with its shareholders is under fire. By considering shareholders the exclusive beneficiaries of the board's fiduciary duties and by allowing only shareholders to sue on the corporation's behalf to enforce these duties, the traditional rules force directors, in the interest of avoiding liability, not to respond to the interests of other stakeholders, particularly when they conflict with those of the shareholders. Because of criticism of the traditional model, Professor Dodd's view of the corporation as an enterprise comprised of a number of varying constituencies has resurfaced.

Twenty-eight states' well-meaning legislative attempts at reform have thus far been flawed. In trying to make directors' decisions reflect concern for the various constituencies that make up the corporate enterprise, nonshareholder corporate constituency statutes actually free up directors' hands, rendering director accountability even more of a fiction than it is under the traditional model. This is true in part because the statutes do not make nonshareholder enforcement a part of their corporate enterprise scheme.

Because it is more theoretically sound, the theory evolving in the courts of Delaware has a brighter future as a basis for putting the corporate enterprise idea into action. Whether or not Chancellor Allen intended the effect, *Credit Lyonnais*'s footnote fifty-five offers the foundation for using situation-specific fiduciary duties to solve the problems with the traditional model's shareholders-only view. With the understanding that in general, the board's fiduciary duties run to all corporate stakeholders, courts could, over time, identify a narrow class of situation-specific directorial duties running to specific stakeholder groups depending on the predicament the corporation faces.

The suggestion that the law recognize situation-specific directorial fiduciary duties is not so drastic a proposal. The law already recognizes such duties in a small class of exceptions to the general rule that the board stands in a fiduciary relationship to the shareholders alone. The traditional model already recognizes that under "special circumstances"—fraud, insolvency, or a director's violation of statute—the directors' fiduciary duties should run to stakeholders other than the shareholders.[164] Indeed, when circumstances change, activating one of the traditional exceptions and

163. *See supra* note 101 (outlining Professor Mitchell's theory that directors will protect interests of those who can sue them if they do not).

164. *See supra* note 55 and accompanying text (listing "special circumstances" that traditional model recognizes as warranting departure from general rule that boards owe no extra-contractual duties to nonshareholders).

shifting the fiduciary duties, courts assess the legality of directors' acts using very different principles than they do before the shift.[165]

In a sense, then, *Credit Lyonnais*'s footnote fifty-five merely challenges the adequacy of the list of existing exceptions. Thus, though footnote fifty-five is part of the philosophical revolution happening in the corporate law, to the extent that it causes changes in fiduciary duties of directors based on circumstances, it represents only an extension of well-rooted, existing principles of law.[166]

Admittedly, optimism that Delaware courts will adopt a rule of situation-specific duties based on *Credit Lyonnais*'s footnote fifty-five could be premature. Even so, footnote fifty-five, has generated its share of hope, attention, and concern among members of the Delaware Bar.[167] In it, Chancellor Allen points the way to a more nuanced analysis, an approach that rejects both the traditional model's extreme position—that board fiduciary duties run just to shareholders—and the statutes' opposite extreme—that the board may consider all corporate constituencies but is, in effect, accountable to nobody.

Tainting the flurry of excitement caused by *Credit Lyonnais*'s footnote fifty-five is its omission of an answer to the question of enforcement. If the Delaware courts plan to implement the legal world's changing outlook on the corporation, they must also effect a corresponding change in corporate directors' incentives in the real world. Incentives for directors to act consistently with the corporate enterprise idea should take the form of potential liability. Without an enforcement mechanism, even if the reemergence of corporate enterprise theory causes the modern corporation to undergo a massive and complete theoretical facelift, the corporation will, as a practical matter, retain the one-track mind of a profit-seeking shareholder. Thus, if the law continues to deny nonshareholder constituencies an enforcement mechanism, the corporate enterprise notion will remain a toothless ideal.

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165. Geyer v. Ingersoll Publications Co., C.V. No. 12406, 1992 WL 136743, at *2 (Del. Ch. June 18, 1992).

166. Winnike, *supra* note 27 (stating that footnote 55 expands range of situations in which directors are fiduciaries of creditors to include near insolvency).

167. *See Footnote of the Year*, *supra* note 25, at 388 (reporting that footnote 55 has caused stir in Delaware); Winnike, *supra* note 27 (describing *Credit Lyonnais* as "potential catalyst" for important changes in Delaware law); *see also* Stephanie J. Seligman, *Just-in-Case: Planning for a Potential Restructuring*, 793 PRACTISING LEGAL INST. CORP. L. AND PRAC. COURSE HANDBOOK SERIES 703 (1992) (describing impact of *Credit Lyonnais*'s footnote 55).