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The Diminishing Duty of Loyalty

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Abstract

Fiduciary duties comprise an integral part of corporate law. It is generally understood that directors owe the corporation and its shareholders two fiduciary duties: the duty of care and the duty of loyalty. Although both duties are firmly established in corporate law, they are not treated equally. It is generally understood that the duty of loyalty is enforced far more rigorously than the duty of care. The justification for this dichotomy is twofold. First, differential treatment is appropriate because of the relative urgencies of the underlying subject matter: loyalty issues pose greater risks than do care issues. Second, the deference of the business judgment rule is made possible by the rigor of the entire fairness test: directors who are not conflicted can be trusted. In this Article, I demonstrate that the duty of loyalty is not enforced as rigorously as is commonly believed. Over fifty years ago, Professor Harold Marsh argued that the duty of loyalty had been watered down substantially over the preceding century. I argue that the diminishment of the duty of loyalty has continued and increased substantially since the time of his writing. I catalog various legal developments that have had the effect of curtailing the enforcement of the duty of loyalty significantly. As a result of these developments, I maintain that the corporate law reality does not currently match the corporate law theory. I argue that some sort of realignment is necessary: either the law must be amended to correspond to the theory, or the theory must be revised to reflect reality.

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I. Introduction

Fiduciary duties comprise an integral part of corporate law:

> One of the fundamental tenets of Delaware corporate law provides for a separation of control and ownership. The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners. Accordingly, fiduciary duties are imposed on the directors of Delaware corporations to regulate their conduct when they discharge that function.[1]

It is generally understood that directors owe the corporation and its shareholders two fiduciary duties: the duty of care and the duty

1. Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

of loyalty.[2] The duty of care requires diligence.[3] Directors are expected to do a good job in managing the company. They breach this duty when they are negligent (or grossly negligent).[4] The duty of loyalty is concerned with conflicts of interest. Directors are expected to act in the interests of the corporation and its shareholders, rather than in their own interests. They breach this duty, *inter alia*, when they engage in unfair self-dealing.[5]

Although both duties are firmly established in corporate law, they are not treated equally. As corporate law scholars and jurists know, the duty of loyalty is enforced far more rigorously than the duty of care. The justification for this dichotomy is twofold. First, differential treatment is appropriate because of the relative urgencies of the underlying subject matter: loyalty issues pose greater risks than do care issues.[6] Second, the deference of the business judgment rule is made possible by the rigor of the entire fairness test: directors who are not conflicted can be trusted.[7]

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2. *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (rejecting good faith as "an independent fiduciary duty that stands on the same footing as the duties of care and loyalty"). *But see generally* Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231 (2010) (arguing that the titular question is misleading and irrelevant, but that the best answer is that there are five duties).

3. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[D]irectors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with the requisite care in the discharge of their duties.").

4. *See id.* ("[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence.").

5. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("[T]he intrinsic fairness standard . . . will be applied only when the fiduciary duty is accompanied by self-dealing.").

6. *See* STEPHEN M. BAINBRIDGE, CORPORATE LAW 141–42 (2d ed. 2009) (arguing that the implications presented by duty of loyalty matters are more significant than duty of care implications).

7. *See* Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 827, 834–35 (2004) ("The deference of the business judgment rule is justifiable only because of, and also makes possible, the rigor of the entire fairness test. The legitimacy of either depends upon the other."); *infra* Part II.B (explaining the complementarity of enforcement of the duties of care and loyalty); *infra* notes 70–73, 96–99, 304 and accompanying text (same); *cf.* FRANKLIN A. GEVURTZ, CORPORATION LAW 341 (2d ed. 2010)

> The idea that directors, with their expertise, are more likely to reach a better business decision than the courts presupposes a situation in which we can trust the directors to act in the best interest of the

In a previous article, I attempted to provide a comprehensive defense of the duty of care.[8] I argued that "the duty of care is not simply an ill-fitting appendage to the duty of loyalty, but rather an essential aspect of the singular fiduciary concept that also encompasses the duty of loyalty."[9] Properly understood, fiduciary law principles demand that the fiduciary "act in the interests of the beneficiary in all relevant respects."[10] Although I acknowledged that a cost-benefit analysis supports under-enforcement of care issues, I argued that the appropriate level of enforcement is unlikely to be zero.[11]

In this Article, I will develop a complementary theme that was introduced in my previous work. I will argue that the duty of loyalty is not enforced as rigorously as is commonly believed. As a result, the corporate law reality does not currently match the corporate law theory. This is important because the deference of the business judgment rule with respect to care issues is often justified, at least in part, by reference to the rigor of the entire fairness test with respect to loyalty issues.[12] If this justification fails, then some sort of realignment seems necessary.

My argument will proceed as follows. In Part II, I will set forth the common wisdom on the duty of loyalty. I will start by discussing the claim, advanced by Professor Harold Marsh, Jr. over fifty years ago, that the duty of loyalty had been watered down substantially over the preceding century.[13] Although the argument has received general acceptance, it has not fundamentally

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> corporation. After all, what advantage is expertise if we cannot trust the directors to use their expertise in the company's best interest? Needless to say, when the directors have a personal financial interest in conflict with the corporation's, there is a reason not to trust the directors.

8. *See generally* Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647 (2015).

9. *Id*. at 648.

10. *Id*.

11. *See id*. at 661 ("[T]here are reasons to believe that a cost-benefit analysis would not support eliminating the duty of care.").

12. *See generally supra* note 7 and accompanying text.

13. *See generally* Harold Marsh, Jr., *Are Directors Trustees?: Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966) (exploring the history of the enforcement of the duty of loyalty).

undermined confidence in the duty of loyalty.[14] I will then set forth the prevailing corporate law narrative: that the duty of loyalty is enforced by means of rigorous judicial review under the entire fairness test.[15]

Part III is the heart of this Article. In this Part, I will demonstrate that the diminishment of the duty of loyalty that was observed by Marsh has continued and increased substantially since the time of his writing.[16] I will elaborate on various legal developments that have had the effect of curtailing enforcement of the duty of loyalty. In Part IV, I will consider other legal developments that seemed to offer hope as mitigating forces.[17] However, I will show that ultimately they did not live up to their promise. The goal of these two Parts is to show that, contrary to popular belief, enforcement of the duty of loyalty is quite lax. This raises the question of whether shareholders may be under-protected from conflicts of interest of management.

In Part V, I will consider the implications of this realization. I will argue that there are three possible responses for the law to take.[18] The first approach would be to recognize the problem and scale back on the developments that have diminished the enforcement of the duty of loyalty. I will briefly consider a few avenues for doing so. The second approach would be to leave recent developments alone, but to devise alternative strategies to mitigate the negative effects of the diminished duty of loyalty. Again, I will briefly consider a few possibilities. The third approach would be to do nothing. It may be that all of the developments are entirely justified, and the diminishment of the duty of loyalty is wholly appropriate. Nevertheless, I will argue that, if this is the case, we should embrace this truth explicitly, and revise the misleading corporate law narrative that seems to demand a rigorous duty of loyalty. The status quo is not in keeping with the corporate law narrative; one or the other must yield.

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14. *Infra* Part II.A.
15. *Infra* Part II.B.
16. *Infra* Part III.
17. *Infra* Part IV.
18. *Infra* Part V.

II. Common Wisdom

The duty of loyalty lies at the very heart of fiduciary law. "[T]o prohibit fiduciaries from misappropriating or misusing entrusted property or power . . . the duty of loyalty is manifested by important preventative rules."[19] One such rule is the "no conflicts" rule. A classic formulation can be found in the case of *Guth v. Loft, Inc.*[20]:

> The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. . . . The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.[21]

And yet, corporate law has taken a more lenient approach towards conflicts of interest. Conflicted transactions are not strictly prohibited; instead, they are regulated. The first section below focuses on Marsh's seminal article, which documented corporate law's move from the strict fiduciary rule to a more permissive stance.[22] The second section sets forth the prevailing corporate law narrative on the duty of loyalty: that, despite these changes identified by Marsh, corporate law maintains a robust enforcement of the duty of loyalty through careful judicial scrutiny under the entire fairness test.[23]

A. Marsh's Claim

The starting point for any discussion of a diminishing duty of loyalty in corporate law is the seminal article written by Marsh half a century ago.[24] Marsh argued that the courts had watered

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19. TAMAR FRANKEL, FIDUCIARY LAW 108 (2011).
20. 5 A.2d 503 (Del. 1939).
21. *Id.* at 510.
22. *Infra* Part II.A.
23. *Infra* Part II.B.
24. *See generally* Marsh, *supra* note 13.

down the protections of the duty of loyalty over time. In particular, he identified three time periods that demonstrate this downward trajectory:

> In 1880 it could have been stated with confidence that in the United States the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction.
>
> . . . .
>
> It could have been stated with reasonable confidence in 1910 that the general rule was that a contract between a director and his corporation was valid if it was approved by a disinterested majority of his fellow directors and was not found to be unfair or fraudulent by the court if challenged; but that a contract in which a majority of the board was interested was voidable at the instance of the corporation or its shareholders without regard to any question of fairness.
>
> . . . .
>
> By 1960 it could be said with some assurance that the general rule was that no transaction of a corporation with any or all of its directors was automatically voidable at the suit of a shareholder, whether there was a disinterested majority of the board or not; but that the courts would review such a contract and subject it to rigid and careful scrutiny, and would invalidate the contract if it was found to be unfair to the corporation.[25]

This account has gained general acceptance among legal scholars. It describes a very clear move from a flat prohibition against conflict of interest transactions to their regulation. Whether this move was a positive development or a negative one may be open to debate, but the fact that it represents a weakening of the rigor of the duty of loyalty is not.

In fact, Marsh clearly viewed this as a negative development. He argued that the change occurred abruptly, and without

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25. Marsh, *supra* note 13, at 36, 39–40, 43; *see* 2 MODEL BUS. CORP. ACT ANN. §§ 8.60–8.63 introductory cmt. at 8-493 (4th ed. 2011 rev.) (discussing the development of the rule against conflicts).

reasoned explanation by the courts.[26] There is an implicit suggestion that the development was somewhat illegitimate.[27]

Although they seem to have gained general acceptance, Marsh's claims have not gone entirely unchallenged. For example, Norwood Beveridge has argued that Marsh's account was "completely erroneous."[28] Beveridge argued that "interested director contracts were never thought to be voidable without regard to fairness."[29] Rather, the law "categorically prohibit[ed] . . . the fiduciary from standing on both sides of the transaction."[30] He claims that "the consent of an informed board would [always] suffice" to validate the transaction.[31] However, Beveridge's claims have not gained much traction. For example, Professor Melvin Eisenberg reviewed the evidence and disagreed with Beveridge: "Beveridge makes an important contribution in pointing to [certain] authorities. However, a clear majority of the early cases support Marsh."[32]

David Kershaw has offered a much more interesting and nuanced critique of Marsh's thesis.[33] He argues that "the path of U.S. self-dealing law from voidability to fairness is not illogical and unexplained . . . . [T]he path to fairness is consistent with the early 19th-century fiduciary law and the options made available by the U.S. conception of the corporation."[34] Kershaw's disagreement with Marsh is not about Marsh's account of the law itself. Rather, Kershaw takes issue with Marsh's assessment of the development

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26. *See* Marsh, *supra* note 13, at 40–41, 43–44, 53 ("One searches in vain in the decided cases for a reasoned defense of this change in legal philosophy . . . .").

27. *See id.* at 40 ("Did the courts discover . . . that greed was no longer a factor in human conduct? If so, they did not share the basis of this discovery with the public; nor did they humbly admit their error when confronted with the next wave of corporate frauds . . . .").

28. Norwood P. Beveridge, Jr., *The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Transaction*, 41 DEPAUL L. REV. 655, 659 (1992).

29. *Id.* at 660.

30. *Id.* at 661.

31. *Id.*

32. WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 651 (7th ed. unabr. 1995). This is an earlier version of his casebook. Subsequent versions have not even included a discussion of Beveridge's theory.

33. *See generally* David Kershaw, *The Path of Corporate Fiduciary Law*, 8 N.Y.U. J.L. & BUS. 395 (2012).

34. *Id.* at 405.

of the law—in particular, the claim that the move from voidability to fairness review was unexplained.[35] Kershaw insists that the seeds of fairness review already existed in fiduciary law and would eventually come to displace voidability.[36]

Kershaw used various examples to illustrate his point. With respect to New Jersey law, Kershaw acknowledges that there was a strict rule against conflicted transactions.[37] However, the remedy of voidability was limited to unexecuted contracts; for executed contracts, directors were entitled to fair compensation.[38] According to Kershaw, "[t]he shift to a substantive fairness standard merely requires the recognition that, from a liability perspective, there is no difference between a strict rule coupled with a remedial fairness standard and a substantive fairness standard."[39] With respect to New York law, Kershaw argues that a shift in perception of a conflicted transaction from involving merely two parties—the conflicted director and the shareholders—to involving three—adding the board, which may not be conflicted—opened the door to the change in law:

> Following the structure of 19th-century fiduciary law, if the transaction involves the exercise of power [by a fiduciary], then it is subject to the strict structural loyalty-based approach that prohibits such transactions, regardless of actual loyalty, and renders them voidable at the corporation's or its shareholders' election. If the transaction involves influence [of a fiduciary], then the standard is one of fairness.[40]

Thus, argues Kershaw, the development of the law from strict voidability to fairness review was not inexplicable.[41]

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35. *See id.* ("[T]he path of U.S. self-dealing law from voidability to fairness is not illogical and unexplained . . . .").

36. *See id.* ("[T]he path to fairness is consistent with the early 19th-century fiduciary law and the options made available by the U.S. conception of the corporation.").

37. *See id.* at 445–47 (discussing prohibition of conflicted transactions in *Stewart v. Lehigh Valley R.R. Co.*, 38 N.J.L. 505 (1875)).

38. *See id.* at 448–50 (discussing remedies under *Gardner v. Butler*, 30 N.J. Eq. 702 (1879)).

39. *Id.* at 451–52.

40. *Id.* at 464.

41. *See id.* at 405 ("[T]he path of U.S. self-dealing law from voidability to fairness is not illogical and unexplained . . . . On the contrary, the path to fairness is consistent with early 19th-century fiduciary law and the options made available

It is important to note that Kershaw does not argue that the law did not change. To the contrary, Kershaw acknowledges that the "initial step in U.S. regulation of self-dealing appears wholly consistent with the first stage of Marsh's account of the development of this area of the law."[42] Kershaw merely seeks to explain what Marsh had claimed was inexplicable and unprincipled.[43]

It is equally important to note that Kershaw does not claim that the changes were inevitable. The forces he discusses merely "created an opening"[44] for the change that occurred. But, things could have developed otherwise. For example, Kershaw suggests that the shift from a strict rule to remedial fairness to a rule of substantive fairness "[a]rguably, . . . amounted merely to a functional tidying-up of the case law."[45] However, the law could have developed in the opposite direction: once it was realized that remedial fairness undercuts the voidability rule, the courts could have embraced voidability and abandoned remedial fairness rather than embrace fairness and abandon voidability. This option would have strengthened the rigor of the duty of loyalty; instead, courts chose the option that weakened it. Likewise, the power/influence dichotomy may explain the introduction of the fairness test into the mix. However, it cannot explain the abandonment of voidability.

Ultimately, then, the law developed in a way that diminished the vigor of the duty of loyalty even though this was not necessary or inevitable. Thus, Marsh's essential claim is correct. Kershaw establishes that legal developments are not entirely inexplicable, but he does not deny that they occurred.

One might have expected that Marsh's claim would undermine the role of the duty of loyalty in corporate law theory. It did not. A strong duty of loyalty remains central. The corporate narrative merely adjusted to reflect the new reality: rather than emphasizing strict prohibition of conflicts, the focus changed to

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by the U.S. conception of the corporation.").

42. *Id.* at 441.

43. *See id.* at 478 (noting that "the . . . shift in . . . case law, which Marsh rightly identified . . . is not unexplained in common law evolutionary terms," even if it "is unexplained, indeed inexplicable, in policy terms").

44. *Id.* at 469.

45. *Id.* at 456.

finding acceptable alternatives, including searching judicial review via the entire fairness test.

B. The Prevailing Narrative

It is well known that corporate law responds very differently to claims of breach of the duty of care and breach of the duty of loyalty.[46] "A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation."[47] This is the foundation for the business judgment rule, which the Delaware courts call "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company,"[48] but which could also be considered a deferential standard of review or even "a policy of non-review" for duty of care cases.[49] With respect to the decision-making process, "director liability is predicated upon concepts of gross negligence."[50] With respect to substance, directors' decisions "will not be disturbed if they can be attributed to any rational business purpose."[51] It is clear to all that it is very difficult, if not impossible, to prevail on a duty of care claim.[52]

By contrast, "it has been traditional for the duty of loyalty to be articulated capaciously."[53] The following two passages are

46. *See* Velasco, *supra* note 7, at 827 ("The leniency of the business judgment rule embodies the principle of directorial authority, while the strictness of the entire fairness test embodies the principle of directorial accountability.").

47. Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

48. *Id.* at 812.

49. Velasco, *supra* note 7, at 828–29, 828 n.18 (citing sources).

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

51. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

52. Under the business judgment rule alone, prevailing on a duty of care claim is very difficult. When an exculpation provision is in place, it may be impossible. For a discussion of exculpation provisions, see *infra* notes 275–279 and accompanying text.

53. Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 634 (2010); *see, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (stating that the Delaware Supreme Court "has traditionally and consistently defined the duty of loyalty of officers and directors to their corporation and its shareholders in broad and

among the most iconic articulations of the duty of loyalty. The first is from *Meinhard v. Salmon*[54]:

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[55]

The second is from *Guth v. Loft, Inc.*:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.[56]

Passages such as these leave no doubt about the importance of the duty of loyalty in corporate law. Although the opinions in these passages may seem dated, they remain among the most

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unyielding terms").

54. 164 N.E. 545 (N.Y. 1928).

55. *Id.* at 546.

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

quoted and celebrated passages in corporate fiduciary law. They form the backdrop of the legal landscape of fiduciary duties.

Rather than continuing to emphasize the prohibition of all conflicts of interest, however, corporate law today focuses attention on methods of minimizing the negative impact of permissible conflicts. The method that is most closely associated with the duty of loyalty is strict judicial review.[57] If there is a cognizable conflict of interest, then the transaction must withstand scrutiny under the entire fairness test.

Under the entire fairness test, the directors bear the burden of establishing that the transaction in question is entirely fair to the company and its shareholders.[58] The inquiry has both a procedural and a substantive component[59]:

> The concept of fairness has two basic aspects: fair dealing [process] and fair price [substance]. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed [transaction], including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. . . . However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.[60]

This is a far cry from the deference that is the hallmark of the business judgment rule.[61]

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57. An alternative is to eliminate the conflict by relying on unconflicted directors. *See infra* Part III.A (discussing disinterested review).

58. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (describing directors' burden under the entire fairness test).

59. *See Cede & Co.*, 634 A.2d at 361 ("Under the entire fairness standard of judicial review, the defendant directors must establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price." (citing Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983))).

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

61. *See supra* notes 46–52 and accompanying text (discussing deference in the business judgment rule).

The courts have described their scrutiny under the entire fairness test as "careful,"[62] "exacting,"[63] "strict,"[64] and "the most searching and objective analysis."[65] "Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs."[66]

Far from being deferential, the entire fairness test has been called "the highest standard of review in corporate law"[67] and "Delaware's most onerous standard."[68] In fact, the courts have even noted that "[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome."[69]

Why this dichotomy between care and loyalty? Although much more can and has been written on the subject, it is largely because of trust. Normally, we believe that we can trust directors to act in the interests of shareholders, but this is not true when directors have conflicts of interest.[70] As the Delaware Supreme Court has explained it,

> In business judgment rule cases, an essential element is the fact that there has been a business decision made by a disinterested and independent corporate decisionmaker. . . . When there is no

62. *Weinberger*, 457 A.2d at 710.

63. Paramount Comm., Inc. v. QVC Network, Inc., 637 A.2d 34, 42 n.9 (Del. 1994).

64. Solomon v. Armstrong, 747 A.2d 1098, 1112 (Del. Ch. 1999).

65. Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 663 (Del. 1952).

66. Gesoff v. IIC Indus., Inc., 902 A.2d 1130, 1145 (Del. Ch. 2006).

67. Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

68. *In re* Cornerstone Therapeutics Inc., Stockholder Litig., 115 A.3d 1173, 1180 n.28 (Del. 2015) (quoting *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 44 (Del. Ch. 2013)).

69. AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986). *But see infra* note 120 and accompanying text (noting that the application of the entire fairness test is not actually outcome determinative).

70. *See* Velasco, *supra* note 7, at 834–35 ("If the key insight of the business judgment rule is that directors generally can be trusted, the key insight of the entire fairness test is that this is not always so.").

> independent corporate decisionmaker, the court may become the objective arbiter.[71]

In other words, "director independence inheres in the rationale for the business judgment rule."[72] However, when directors are conflicted, courts are needed to step in and review their decisions. Thus, as I have previously argued, "[t]he deference of the business judgment rule is justifiable only because of, and also makes possible, the rigor of the entire fairness test. The legitimacy of either depends upon the other."[73]

The business judgment rule arguably is the foundation of corporate law.[74] However, its theoretical justification is dependent upon a rigorous enforcement of the duty of loyalty. Thus, it is important to know whether judicial scrutiny via the entire fairness test can carry the theoretical weight that is placed on its shoulders. In the next Part, I will argue that it cannot. The duty of loyalty is not enforced as rigorously as the prevailing narrative suggests, and this undermines the entire theoretical structure of corporate law.

III. Developments

In the previous Part, I set forth the prevailing narrative about the duty of loyalty in corporate law: that conflicts of interest are policed by a robust entire fairness test. In this Part, I will demonstrate that the prevailing narrative is descriptively inaccurate. The diminishment of the duty of loyalty that was observed by Marsh long ago has continued to the point where, today, fairness review plays only a minor role in policing conflicts of interest.

I will point to five categories of developments that have undermined the enforcement of the duty of loyalty. First, legislative and judicial developments have permitted conflicted

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71. Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993); *see also* Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991) ("The key to upholding an interested transaction is the approval of some neutral decision-making body.").

72. Schoon v. Smith, 953 A.2d 196, 207 (Del. 2008).

73. Velasco, *supra* note 7, at 827.

74. *Supra* note 47 and accompanying text.

transactions to proceed without resort to judicial review.[75] Second, courts have limited the types of conflicts that they are willing to recognize as raising duty of loyalty issues.[76] Third, the rigor of judicial scrutiny has been reduced from a strict entire fairness review to a more forgiving range of fairness test.[77] Fourth, it should not be forgotten that the standing requirements for bringing a derivative action also severely reduce the enforcement of the duty of loyalty.[78] Finally, corporate law statutes have been amended to allow for the waiver of corporate opportunities, despite the loyalty issues involved.[79] The point of this Part is not to criticize any particular development, but rather to paint a comprehensive picture of the status quo. Enforcement of the duty of loyalty is not as robust as is commonly believed.

A. Disinterested Review

When Marsh left off, conflicted transactions were never automatically voidable but would always be subject to fairness review.[80] That is not how things stand today. Many transactions involving interested directors are not subject to fairness review, but actually receive the deference of the business judgment rule.[81]

One major impetus for the change was the widespread adoption of sanitizing statutes, such as the 1967 adoption of Section 144 in Delaware.[82] Marsh noted this trend just before Delaware adopted its provision.[83] Such statutes generally abrogate the common law rule by providing that conflicted transactions are not void or voidable as long as they are approved by fully informed, disinterested directors or shareholders, or are otherwise deemed

75. *Infra* Part III.A.

76. *Infra* Part III.B.

77. *Infra* Part III.C.

78. *Infra* Part III.D.

79. *Infra* Part III.E.

80. *See* Marsh, *supra* note 13, at 43 (discussing "[j]udicial review of the fairness of the transaction" during the 1960s).

81. *See, e.g.*, *infra* note 88 and accompanying text (discussing instances where interested transactions are not subject to fairness review).

82. DEL. CODE ANN. tit. 8, § 144 (West 2017).

83. *See* Marsh, *supra* note 13, at 46–48 (noting the recent adoption of sanitizing statutes).

fair by the courts.[84] On their face, they seem to provide that conflicted transactions may be sanitized by any one of the three listed methods.[85] However, as Marsh noted, many courts at first read the statute in a more limited manner[86]: as "merely remov[ing] an 'interested director' cloud when its terms are met and provid[ing] against invalidation of an agreement 'solely' because such a director or officer is involved . . . [but not] remov[ing] the transaction from judicial scrutiny."[87] Yet, over time, courts have come to the view that satisfactory approval by directors or shareholders generally invokes the business judgment rule after all.[88]

Corporate law has extended these principles beyond the strict confines of the statutory language. For example, transactions involving controlling shareholders as such are not, as a technical matter, covered by the language of Section 144.[89] Nevertheless, the courts held that such transactions would also be permitted along

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84. *See* 1 EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 144.01, at 4-367 (6th ed. 2014-2 Supp) ("The principle of voidability for interested transactions, which was sometimes characterized as the common-law rule, was significantly ameliorated by the 1967 enactment of section 144 of the Delaware General Corporation Law.").

85. *See* DEL. CODE ANN. tit. 8, § 144 (providing that no transaction "shall be void or voidable" because of a director interest or conflict if the transaction is approved by fully-informed disinterested directors or fully informed shareholders, or is deemed fair by the courts).

86. *See* Marsh, *supra* note 13, at 47 ("[T]here is a California decision which indicates that the courts will in any event review the transaction for fairness (whatever the statute says).").

87. Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976).

88. *See* Benihana of Tokyo, Inc. v. Benihana, Inc. 906 A.2d 114, 120 (Del. 2006) (discussing disinterested director approval); *cf.* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 311–13, 313 n.28 (Del. 2015) (discussing "long-standing policy . . . to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide . . . for themselves"). As a technical matter, Delaware law does maintain a difference between the statutory framework and the requirements of the common law; however, the two have largely run together such that adequate director or shareholder approval (i.e., approval that is both disinterested and independent) will invoke the business judgment rule. *See generally* 1 STEPHEN A. RADIN ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 806–10 (6th ed. 2009).

89. *See* DEL. CODE ANN. tit. 8, § 144 (discussing directors' conflicted transactions).

similar lines.[90] However, there was a substantial difference: such transactions were always subject to judicial review. A controlling shareholder was not required to obtain the approval of independent directors or shareholders,[91] but doing so would shift the burden of proof on the issue of fairness.[92] Originally, the cases held that independent director or shareholder approval would not invoke the business judgment rule out of concern that truly independent approval might not be possible in the face of a controlling shareholder.[93] Recently, however, the Delaware Supreme Court has decided that a controlling shareholder could invoke the business judgment rule after all—by seeking the approval of both independent directors and independent shareholders.[94] In the court's opinion, the combination of two levels of independent approval provides the optimal level of protection for shareholder interests.[95] Although this may be true, it clearly reverses the court's prior reticence.

The idea of substituting other neutral decisionmakers for judicial review has a great deal of merit. However, it requires confidence that the decisionmaker is, in fact, neutral.[96] Otherwise,

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90. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (allowing majority shareholders to benefit from shareholder ratification). Although in some respects this case was decided on the grounds of director conflict, it also involved a controlling shareholder and has been regularly cited as precedent regarding controlling shareholders.

91. *See id.* at 709 n.7 ("Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length.").

92. *See id.* at 703 (discussing burden-shifting framework); Kahn v. Lynch Comm. Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) (same); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) (same).

93. *See Kahn*, 638 A.2d at 1116–17 ("The controlling stockholder relationship has the potential to influence, however subtly, the vote of [ratifying] minority stockholders . . . ." (citing Citron v. I.E. DuPont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990))).

94. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645–46 (Del. 2014) (adopting new test for controlling shareholder to invoke the business judgment rule).

95. *See id.* at 644 ("'[W]hen these two protections are established up-front, a potent tool to extract good value for the minority is established.'" (citation omitted)).

96. *See supra* notes 70–73 and accompanying text (emphasizing the importance of trust in the independence of the decisionmaker).

the extreme deference of the business judgment rule is inappropriate. There is reason to question whether directors can be considered entirely neutral. The principal reason is structural bias:[97] even a director who has no immediate financial interest in a decision may be biased in favor of a fellow director or an officer because of considerations of collegiality and friendship, for example.[98] Although structural bias is not as likely as a direct conflict to lead to lying, cheating, or stealing, it is capable of clouding disinterested directors' objectivity.[99] Thus, it undermines confidence in the neutrality of the decisionmaker and suggests a need for judicial review.

In short, the watering down of duty of loyalty has continued. Marsh noted the move from a rule of strict voidability to a rule of fairness review.[100] Since his time, the courts have been moving to a legal regime that, in many cases, eschews fairness review altogether and allows transactions that involve acknowledged conflicts of interest to receive the deference of the business judgment rule.

B. Cognizability

The purpose of the duty of loyalty is to ensure that fiduciaries pursue the interests of their beneficiaries, as opposed to anyone else's interests. The primary tool employed by the duty of loyalty is a prohibition against fiduciaries acting with conflicts of interest. The goal is to eliminate motivations that fiduciaries may have not

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97. "The term 'structural bias' generally refers to the prejudice that members of the board of directors may have in favor of one another and of management." Velasco, *supra* note 7, at 824. For other definitions of structural bias, see *id.* at 824 n.4.

98. *See* Velasco, *supra* note 7, at 856–65 (discussing three different paradigms for understanding structural bias: implicit conspiracy, friendship and collegiality, and in-group bias).

99. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (discussing the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders"); Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981) (discussing "where inquiry as to independence . . . is sufficient safeguard against abuse, perhaps subconscious abuse").

100. *Supra* note 25 and accompanying text; *see* Marsh, *supra* note 13, at 43–47 (discussing "[j]udicial review of the fairness of the transaction").

to pursue the interests of beneficiaries.[101] The rationale is that fiduciaries are far more likely to act in the interests of beneficiaries if they have no reason not to do so.[102] These general principles apply in corporate law, but in a highly circumscribed manner.

Corporate law does not focus on all conflicts of interest, but is much more concerned with a subset thereof. To raise a legally cognizable loyalty issue, shareholders generally must assert that the directors have engaged in self-dealing.[103] "Classic examples of . . . [self-dealing] involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally."[104] To be fair, self-dealing is not strictly required. However, the conflict must "rise to the level of self-dealing"[105] to invoke the entire fairness test.[106] Conflicts that fall short of that are effectively ignored.[107]

When does a conflict rise to the level of self-dealing? Many conflicts that might be thought to compromise a director's independence, such as friendship, are generally considered insufficient.[108] Generally, to be cognizable, a conflict must consist of either a personal or familial financial interest.[109] Even so, not all

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101. *See supra* notes 19–21 and accompanying text (explaining the goal of the duty of loyalty).

102. *See supra* note 21 and accompanying text (discussing "a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach"); *see also* FRANKEL, *supra* note 19, at 108 ("[T]he duty of loyalty is manifested by important preventative rules . . . [which] act to dampen the fiduciaries' temptations to misappropriate entrusted property or power . . . .").

103. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

104. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 362 (Del. 1993).

105. *Id.* at 363 (citing *Aronson*, 473 A.2d at 812.

106. *See id.* (discussing the requirement of self-dealing); Sinclair Oil v. Levien, 280 A.2d 717, 720 (Del. 1971) (same).

107. *See Sinclair Oil Corp.*, 280 A.2d at 722 (applying the business judgment standard instead of the entire fairness test in the absence of self-dealing).

108. *See* Beam v. Stewart, 845 A.2d 1040, 1050 (Del. 2004) ("Not all friendships, or even most of them, rise to this level and the Court cannot make a *reasonable* inference that a particular friendship does so without specific factual allegations to support such a conclusion.").

109. *See* ALI, PRINCIPLES OF CORPORATE GOVERNANCE § 1.23 (1994) (describing a director or officer as "interested" if "he or she is a party to the transaction, or if a person with whom the director or officer has a business,

financial conflicts will be sufficient to invoke the entire fairness test. The financial interest generally must also be "material"[110]: that is, it "requires a showing that such an interest is reasonably likely to affect the decision-making process of a reasonable person."[111] Moreover, materiality is determined on a subjective, rather than an objective, level[112]—an "actual person" test rather than a reasonable person test.[113] Even so, courts have held that director compensation will not be considered a material conflict,[114] even though it can be fairly substantial as to directors of modest means.[115]

Furthermore, even if the self-dealing of a director can be established, it will not be sufficient to invoke the entire fairness test. In order to do so, a plaintiff generally must show that a majority of directors are conflicted under the same demanding standard.[116] Moreover, even if a majority of directors are conflicted,

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financial or familial relationship, has a material pecuniary interest, or if the director or officer is subject to controlling influence by a party to the transaction or one having a pecuniary interest in it").

110. If the case involves classic self-dealing, where the defendant is on both sides of a transaction, a showing of materiality is not required. *See* Orman v. Cullman, 794 A.2d 5, 26 & n.50 (Del. Ch. 2002) (discussing materiality requirement); HMG/Courtland Props., Inc. v. Gray, 749 A.2d 94, 113–15 (Del. Ch. 1999) (same); Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 887 n.20 (Del. Ch. 1999) (same).

111. *Cede & Co.*, 634 A.2d at 363.

112. *See Orman*, 794 A.2d at 23 ("Materiality means that the alleged benefit was significant enough '*in the context of the director's economic circumstances*, as to have made it improbable that the director could perform her fiduciary duties . . . .'" (citations omitted)).

113. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1167 (Del. 1995) ("[T]he 'actual person' test requires an independent judicial determination regarding the materiality of the '*given'* director's self-interest.").

114. *See* Grobow v. Perot, 539 A.2d 180, 188 (1988) ("Plaintiffs plead no facts demonstrating a financial interest on the part of GM's directors . . . [except] the allegation that all GM's directors are paid for their services as directors. However, such allegations, without more, do not establish any financial interest.").

115. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 359–60 (Del. Ch. 1998) (concluding that, even though the director was "the principal of the elementary school that [the CEO's] children once attended," she was not conflicted "merely because of the relatively substantial compensation provided by the board membership compared to their outside salaries").

116. *See Orman*, 794 A.2d at 22 ("To rebut successfully business judgment rule presumptions . . . , thereby leading to the application of the entire fairness standard, a plaintiff must normally plead facts demonstrating 'that a *majority* of the director defendants have a financial interest in the transaction or were

it remains possible for them to turn the matter over to a committee of disinterested directors to decide the matter.[117] And, as we will see, even if directors fail this test, it may be possible for them to get a second bite at the apple.[118]

These are fairly difficult obstacles for plaintiffs to overcome. As a result, many real conflicts that could and actually do affect a director's judgment are effectively ignored. If this were the standard for review on the merits, it might be appropriate. However, it is the standard used to determine whether there will be any review on the merits. After all, if a case does not involve a conflict that rises to the level of self-dealing, it is relegated to the extreme deference of the business judgment rule. As a result, many real conflicts will escape review under the corporate law duty of loyalty.

C. Fairness

Even if the plaintiffs can invoke the entire fairness test successfully, their problems are far from over. This is because the meaning of fairness review itself has undergone significant change over the years. Once upon a time, the entire fairness test was described in very demanding terms.[119] This is no longer true.

Recently, courts have begun to opine that the entire fairness test is not so demanding after all. Courts will note, for example, that the test is not actually outcome determinative.[120] Where

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dominated or controlled by a materially interested director.'" (citations omitted)).

117. DEL. CODE ANN. tit. 8, § 141(c) (West 2017); *see* Stegemeier v. Magness, 728 A.2d 557, 562 (Del. 1999)

> The absolute prohibition under common law against self-dealing by a trustee has been modified in the corporate setting to offer a safe harbor for the directors of a corporation if the transaction is approved by a majority of disinterested directors. Transactions approved by the directors are therefore not voidable because there are interested directors, if a committee of disinterested directors approves the transaction. In such a case the directors are protected by the business judgment rule.

118. *See infra* note 159 and accompanying text (discussing the creation of special litigation committees).

119. *See supra* notes 62–69 and accompanying text (describing the entire fairness test as "the highest standard of review in corporate law").

120. *See Cinerama*, 663 A.2d at 1163 ("[A]n initial judicial determination that

courts used to speak of rigor, they now emphasize that the test does not demand a perfect decision.[121] Moreover, the Delaware Court of Chancery has increasingly taken to speaking of a "range of fair value"[122]—which even it has referred to as "amorphous."[123] Such language is strongly suggestive of the possibility that directors can be somewhat off the mark but still in compliance. This is not "the most scrupulous inherent fairness,"[124] but more like *mere* fairness.

The use of the term "range" is significant. It is undoubtedly true that fair value is not a clear, discrete point, and thus could be considered to be a range. However, a range implies both an upper and lower limit. But there should be no upper limit to fairness review: an overly-generous offer would certainly pass the fairness test. Thus, fairness is actually a threshold, not a range. What the use of the term "range" does, as a rhetorical matter, is blur the lower limit, making it more difficult to assert that any given value is unfair. Courts should be asking whether it is clear that the given value is fair to shareholders; instead, they are starting to ask whether it is in the ballpark. Thus, shifting the rhetoric from "the most scrupulous inherent fairness" to a "range of fair value" waters down the standard of review significantly.

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a given breach of a board's fiduciary duties has rebutted the presumption of the business judgment rule does not preclude a subsequent judicial determination that the board action was entirely fair, and is, therefore, not outcome-determinative *per se*."); *see also* Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("It is sometimes thought that the decision whether to apply the business judgment rule or the entire fairness test can be outcome-determinative. . . . Application of the entire fairness rule does not, however, always implicate liability of the conflicted corporate decisionmaker, nor does it necessarily render the decision void.").

121. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1179 (Del. 1995) ("A finding of perfection is not a *sine qua non* in an entire fairness analysis."); *see also* Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (stating that "perfection is not possible, or expected"); Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 23 (Del. 2017) ("To be sure, 'fair value' does not equal 'best value.'" (citation omitted)).

122. *See, e.g.*, Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 465 (Del. Ch. 2011) ("When conducting a fair price inquiry as part of the entire fairness standard of review, the court asks whether the transaction was one 'that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.'" (quoting *Cinerama*, 663 A.2d at 1143)).

123. *In re* Cox Comm., Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2010).

124. *Weinberger*, 457 A.2d at 710.

In addition, the courts have deemphasized the need for directors to "establish 'to the *court's* satisfaction that the transaction was the product of both fair dealing *and* fair price,"[125] and have begun to focus on the importance of the substantive component of price.[126] Although this might seem to be a shareholder-friendly development, there are at least two reasons why it is not necessarily so. First, as just mentioned, the rigor of price analysis has been watered down by the "range of fairness" analysis. This makes the process, or dealing, component relatively more important. Second, courts are much less expert with respect to the substance of business decisions than they are with respect to process. Because it is difficult to be confident about price, courts also need to scrutinize the process by which the price was derived. After all, it is difficult to see how a price that could have been improved with a fair process could be considered fair, no matter how generous it may seem. Thus, in at least some cases, shareholders may be shortchanged by a truncated analysis.

To show how low the standard of review has fallen, one need only consider the case of *Cinerama, Inc. v. Technicolor, Inc.*[127] In that case, the Delaware Supreme Court held that although the directors were grossly negligent, the transaction was nevertheless entirely fair to the shareholders.[128] As a formal matter, that is not a logical inconsistency. However, it does seem odd that conduct that failed under the very deferential standard could nevertheless be upheld under the more demanding standard. More importantly, the process was anything but fair, given the presence of gross negligence. The trial court even "recognize[d] the force of the claim that a process that is uninformed can never be fair to shareholders."[129] However, such concerns did not weigh the court down very far. It held that, despite the directors' gross negligence, the transaction was entirely fair—not just fair, but entirely fair!—

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125. *Cinerama*, 663 A.2d at 1163 (quoting Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)).

126. *See, e.g.*, *Weinberger*, 457 A.2d at 711 ("[I]n a non-fraudulent transaction we recognize that price may be the preponderant consideration . . . ."); Kahn v. M & F Worldwide, 88 A.3d 635, 644–45 (Del. 2014) (emphasizing the importance of price in a fairness analysis).

127. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995).

128. *Id.* at 1179–80.

129. *Id.* at 1178 (quoting *Cinerama*, 663 A.2d at 1140).

to the shareholders.[130] It seems reasonable to question whether fairness review can be as demanding as is commonly believed if a transaction that fails under the deferential standards of the business judgment rule can nevertheless prevail under the entire fairness test.

D. Standing

In order to appreciate how weak the duty of loyalty has become, we need to consider another set of issues: the difficulty in pursuing derivative litigation. Most often, when a director breaches the duty of loyalty, it is the corporation itself that has been harmed directly.[131] Shareholders are harmed only indirectly, by virtue of their ownership interest in the corporation.[132] Thus, shareholders do not have a direct cause of action against the directors; the corporation does.[133] However, because of the obvious problem in relying on directors to cause the corporation to sue themselves, courts have allowed shareholders to bring derivative actions on the corporation's behalf—but only under certain circumstances.[134] The general idea is to allow directors to manage the company by making litigation decisions except when conflicts of interest prevent them from exercising their business judgment.[135]

Courts are not only concerned with director prerogative, however. They are also concerned with vexatious litigation

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130. *Id.* at 1179–80.

131. *See* Kramer v. W. Pac. Indus., 546 A.2d 348, 351 (Del. 1984) ("In such a suit [i.e., a 'shareholder's derivative suit'], the shareholder sues on behalf of the corporation for *harm done to it*.").

132. *See* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1037 (Del. 2004) ("[T]he indirect injury to the stockholders arising out of the harm to the corporation comes about solely by virtue of their stockholdings.").

133. *See id.* at 1036 ("The derivative suit has been generally described as 'one of the most interesting and ingenious of accountability mechanisms for large formal organizations.' It enables a stockholder to bring suit on behalf of the corporation for harm done to the corporation.").

134. *See* Lewis v. Anderson, 477 A.2d 1040, 1046 (Del. 1984) ("A derivative action allows a shareholder to circumvent a board's refusal to bring a suit on a claim.").

135. *See Tooley*, 845 A.2d at 1034 (discussing derivative actions); *see also* Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984) (same).

pursued by entrepreneurial attorneys.[136] Thus, the courts have come up with various tests and procedures to weed out undesirable litigation. Each of these developments may have been entirely sensible. In the aggregate, however, these tests may weed out many legitimate shareholder claims.

One requirement for standing to bring a derivative action is known as the contemporaneous ownership rule.[137] In general, a plaintiff must have been "a stockholder of the corporation at the time of the transaction of which such stockholder complains,"[138] and must "maintain their shareholder status throughout the litigation."[139] Although this may be useful as a litigation management device,[140] it is an arbitrary requirement that is not necessarily tied to the economic harm caused by a breach of fiduciary duty.[141]

Perhaps the most difficult hurdle that a shareholder plaintiff must clear is the demand requirement.[142] Before shareholders are permitted to initiate a derivative action, they must make a demand

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136. *See Aronson*, 473 A.2d at 811–12 ("[T]he demand requirement . . . exists [*inter alia*] . . . to provide a safeguard against strike suits."). There are numerous discussions of the concept of attorneys acting like businessmen. *See generally* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation*, 7 J.L. ECON. ORG. 55 (1991). For more favorable perspectives, see generally Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043 (2010); Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103 (2006).

137. *See* WILLIAM MEADE FLETCHER ET AL., 13 FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 5981–5981.50, at 138–57 (perm. ed., rev. vol. 2004) (discussing standing requirements for derivative actions).

138. DEL. CODE ANN. tit. 8, § 327 (West 2017).

139. Parfi Holding AB v. Mirror Image Internet, Inc., 954 A.2d 911, 935 (Del. Ch. 2008).

140. *See* FLETCHER ET AL., *supra* note 137, § 5981.10, at 146–47 (discussing the contemporaneous ownership rule).

141. *See generally* J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 DEL. J. CORP. L. 673 (2008).

142. *See* DEL. CH. CT. R. 23.1 (2007) ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

on the board of directors.[143] Theoretically, this enables directors to pursue the matter in an appropriate way.[144] However, in practice it enables directors to decide that the matter is not worth pursuing.

Some states provide that a demand is not required if it would be futile because of director conflicts.[145] However, in order to claim demand futility, shareholders bear a heavy pleading burden.[146] First, they must allege facts with particularity;[147] conclusory allegations are insufficient.[148] Second, they must show "that a majority of the board of directors either has a financial interest in the challenged transaction or lacks independence or otherwise failed to exercise due care"[149]—essentially, "that the directors are incapable of making an impartial decision regarding such litigation."[150] These are significant obstacles. And all of this must be done on the pleadings—without the benefit of discovery.[151]

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143. *See id.* (same).

144. *See generally* Grimes v. Donald, 673 A.2d 1207, 1216–17 (Del. 1996); Aronson v. Lewis, 473 A.2d 805, 811–12 (Del. 1984); Levine v. Smith, 591 A.2d 194, 200 (Del. 1991).

145. Some states universally require demand. *See* MODEL BUS. CORP. ACT ANN. § 7.42 ("A shareholder may not commence a derivative proceeding until . . . a written demand has been made upon the corporation to take suitable action . . . .").

146. *See* Levine v. Smith, 591 A.2d 194, 207 (Del. 1991) ("Plaintiff's pleading burden under Rule 23.1 is also more onerous than that required to withstand a Rule 12(b)(6) motion to dismiss.").

147. *See Aronson*, 473 A.2d at 808 & n.1 ("[D]emand can only be excused where facts are alleged with particularity . . . .").

148. *See* Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988) ("[W]ell-pleaded allegations of fact must be accepted as true; conclusionary allegations of fact or law not supported by allegations of specific fact may not be taken as true.").

149. *Levine*, 591 A.2d at 205; *see also Grimes*, 673 A.2d at 1216 (discussing requirements to excuse demand). The actual test requires plaintiffs to establish "a reasonable doubt that '(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.'" Rales v. Blasband, 634 A.2d 927, 932 n.6 (Del. 1993) (quoting *Aronson*, 473 A.2d at 814). It is worth noting that this "reasonable doubt" standard bears no resemblance to its criminal law namesake. It actually requires shareholders to create a reasonable belief. *See Grimes*, 673 A.2d at 1217 n.17 ("Stated obversely, the concept of reasonable doubt is akin to the concept that the stockholder has a 'reasonable belief' that the board lacks independence or that the transaction was not protected by the business judgment rule.").

150. *Rales*, 634 A.2d at 932; *see also Levine*, 591 A.2d at 205 ("On either showing, it may be inferred that the Board is *incapable* of exercising its power and authority to pursue the derivative claims directly.").

151. *See Rales*, 634 A.2d at 934–35, 934 n.10 ("[D]erivative plaintiffs may

To be fair, the courts have noted that shareholders have the right to inspect corporate books and records, and may seek to avail themselves of this right before pursuing a derivative action.[152] However, the right is far from absolute: shareholders must demonstrate a proper purpose,[153] and investigating possible misconduct is not a proper purpose unless shareholders can provide some evidence in advance.[154] Moreover, if shareholders do gain access to books and records, they are unlikely to find much. Directors and their lawyers know very well how to sanitize corporate documents so as not to incriminate themselves.[155]

The difficulty of pleading demand futility might suggest that making a demand is the better option. However, shareholders have no choice but to plead demand futility because the Delaware courts have held that making a demand waives any claim of demand futility,[156] and causes the board's subsequent refusal to be reviewed under the business judgment rule.[157] This is a strange holding: there is no logical problem with pleading in the alternative, and plaintiffs generally are free to do so in most

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believe it is difficult to meet the particularized requirement of *Aronson* because they are not entitled to discovery . . . .").

152. *See* DEL. CODE ANN. tit. 8, § 220 (West 2017) (providing that shareholders have a statutory right to inspect the corporations' books and records); *see also* Grimes v. Donald, 673 A.2d 1207, 1216 n.11 (Del. 1996) (discussing "tools at hand"); *Rales*, 634 A.2d at 934 n.10 ("[Shareholders] have many avenues available to obtain information bearing on the subject of their claims.").

153. *See* Seinfeld v. Verizon Comm., Inc., 909 A.2d 117, 121 (Del. 2006) ("In a section 220 action, a stockholder has the burden of proof to demonstrate a proper purpose by a preponderance of the evidence.").

154. *See id* at 123 ("Stockholders [must] show, by a preponderance of the evidence, a credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation . . . .").

155. *See, e.g.*, Leo J. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAW. 679, 680, 695 (2015) (discussing how directors sanitize their documents "to ensure that no advice is reflected in the record that would be inconsistent" with fairness).

156. *See Rales*, 634 A.2d at 935 n.12 (Del. 1993) ("Where a demand has actually been made, the stockholder making the demand concedes the independence and disinterestedness of a majority of the board to respond."); *see also Grimes*, 673 A.2d at 1218–29 (making a demand waives demand futility but does not "waive the right to claim that demand has been wrongfully refused").

157. *See* Spiegel v. Buntrock, 571 A.2d 767, 775–76 (Del. 1990) (reviewing a refused demand); *see also* Levine v. Smith, 591 A.2d 194, 212 (Del. 1991) (same).

litigation.[158] Yet, this option is denied to plaintiffs in derivative litigation, forcing them to make crucial decisions very early on.

The situation is worse still. Even after a derivative action has been properly initiated, directors may be able to establish an independent committee to dismiss the lawsuit.[159] With all of these procedural hurdles, one must marvel at the ability of litigants ever to get a day in court in the first place. While such procedures surely block a great deal of vexatious litigation, it almost certainly blocks much meritorious litigation as well.

E. Corporate Opportunities

One final development is worth noting. It is now possible, under the laws of some states, for corporations to waive corporate opportunities in advance.[160] This is theoretically significant because corporate opportunities fall under the scope of the duty of loyalty, which is supposed to be mandatory rather than a default rule.[161]

In 2000, the Delaware General Corporation Law was amended to provided that

> [e]very corporation . . . shall have power to . . . [r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being

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158. *Cf. Levine*, 591 A.2d at 207, 211 (noting that Rule 23.1 represents a marked departure from notice pleading requirements).

159. *See generally* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (allowing directors to establish an independent committee after litigation has begun).

160. *See, e.g.*, DEL. CODE ANN. tit. 8, § 122(17) (West 2017) (allowing corporations to "[r]enounce . . . any interest or expectancy of the corporation in, . . . business opportunities that are presented to the corporation of 1 or more of its officers, directors or stockholders"); OKLA. STAT. ANN. tit. 18, § 1016(17) (West 2017) ("Every corporation created pursuant to the provisions of the Oklahoma General Corporation Act shall have power to . . . [r]enounce in its certificate of incorporation . . . interest or expectancy of the corporation in . . . specified business opportunities."); WASH. REV. CODE ANN. § 23B.02.020(5)(k) (West 2017) ("The articles of incorporation may contain . . . [a] provision limiting or eliminating any duty of a director . . . to offer the corporation the right to have or participate in any . . . business opportunities . . . .").

161. *See* Gabriel Rauterberg & Eric Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1077 (2017) (discussing the scope of the duty of loyalty).

> offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders.[162]

Eight states have since adopted similar provisions.[163] In the absence of such provisions, it would be problematic for an officer or director to take personal advantage of a business opportunity that is deemed a corporate opportunity. Some states require corporate consent based on full disclosure,[164] while Delaware requires only that the fiduciary treat the corporation fairly.[165] In any event, all decisions are made in light of the specific facts.[166] Under the new laws, however, corporations can waive some or all interests in corporate opportunities in advance, without respect to the particular circumstances. It might not be entirely surprising that such a waiver could be effected by charter amendment, which would require shareholder approval. However, it is noteworthy that it can be done by directors acting on their own.

The significance of this development is difficult to assess. Theoretically, directors have always had the power to waive corporate opportunity issues; these new laws merely give them greater latitude in doing so. Moreover, it must be noted that Delaware reserves the right to review the waiver for breach of fiduciary duty.[167] However, whether such review is as effective as reviewing the circumstances of each opportunity for fairness is questionable. Empirically, Professors Gabriel Rauterberg and Eric Talley have found fairly widespread use of such provisions without

162. DEL. CODE ANN. tit. 8, § 122(17).

163. *See* Rauterberg & Talley, *supra* note 161, at 107 n.11 (citing statutes).

164. *See, e.g.*, Ne. Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1151–52 (Me. 1995) (requiring disclosure and consent in every instance).

165. *See generally* Broz v. Cellular Info. Sys., Inc., 673 A.2d 148 (Del. 1996).

166. *See* Rauterberg & Talley, *supra* note 161, at 1089 (stating that the law "has always permitted boards of directors to 'reject' a corporate opportunity *ex post*—after it has emerged and has been properly presented to the company by a fiduciary interested in pursuing it personally").

167. The legislative history provides that the provision "does not change the level of judicial scrutiny that will apply to the renunciation of an interest or expectancy of the corporation in a business opportunity, which will be determined based on the common law of fiduciary duty, including the duty of loyalty." Delaware Bill Summary, S. 363, 140th Gen. Assembly (Del. 2000); 72 Del. Laws, c. 343, § 3 (2000).

deleterious effects upon shareholders.[168] Thus, it may be that such provisions are harmless. However, it also may be that their abusive potential has yet to be realized. Regardless of whether or not the development is justifiable, it would be difficult to deny that it diminishes the robustness of the duty of loyalty.

F. Conclusion

It should be clear by now that the duty of loyalty has been weakened significantly over time. According to Marsh, "[i]n 1880 it could have been stated with confidence that in the United States the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction."[169] Today, by contrast, it is extremely difficult to prevail on a duty of loyalty claim. There are procedures to allow directors to engage in conflicted transactions without any judicial review. Moreover, judicial review is not available for all conflicts of interest, but only those that rise to the level of self-dealing. Even if self-dealing is established, the courts may allow the transaction to survive if it falls within a range of fairness. But, even that is only true if the shareholders are able to make particularized allegations of demand futility without the benefit of discovery. Even if each of these developments is entirely appropriate, it is difficult to deny that the overall effect is significant.

IV. Counter-Developments

It would be unfair to suggest that all developments regarding the duty of loyalty have had the effect of watering down shareholder protections against director conflicts. The point of the previous Part was merely to establish that the duty of loyalty has been watered down significantly and is not as robust as commonly believed. In this section, I will address a few developments that, over the years, have seemed to offer promise of revitalizing the

168. *See generally* Rauterberg & Talley, *supra* note 161.
169. Marsh, *supra* note 13, at 36.

duty of loyalty. As will become clear, however, the developments have not, to date, panned out as hoped.

A. Intermediate Standards of Review

One development that offered hope for the strengthening of the duty of loyalty has been the creation of various intermediate standards of review for situations that involve conflicts that may not quite rise to the level of self-dealing.[170] Many such standards have been developed,[171] but this section will briefly address three prototypical tests. The first is the *Unocal/Unitrin* standard for review of hostile takeover defenses; the second is the *Zapata* test for reviewing the decision of a special litigation committee to dismiss a derivative action in a demand-excused situation.[172] The third is not always considered an intermediate standard of review, but functions as such: it is the shift in the burden of proof on the issue of fairness when a conflicted transaction has received disinterested approval.[173] Although each of these tests had very promising beginnings, they failed to live up to their expectations.

Consider first the *Unocal/Unitrin* standard. In *Unocal Corp. v. Mesa Petroleum Co.*,[174] the court was faced with a challenge to takeover defenses implemented by a board of directors confronting a hostile takeover.[175] The court appreciated the nature of the threat posed by the hostile offer, deeming it "a classic coercive measure" that demanded a response,[176] but also recognized the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its

170. *See* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 467 (1993) ("[T]he emergence of these intermediate standards of review has been one of the major recent developments in corporate law.").

171. *Id.*; *see also* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1309–16 (2001) (discussing strategy to streamline intermediate standards of review).

172. *See generally* Zapata Corp. v. Maldonado, 430 A.2d. 779 (Del. 1981).

173. *See generally* Kahn v. Lynch Comm. Sys., Inc., 638 A.2d 1110 (Del. 1994).

174. 493 A.2d 946 (Del. 1985).

175. *Id.* at 952.

176. *Id.* at 956.

shareholders."[177] To balance the competing interests, the court developed a two-part test for review of hostile takeover defenses: first, "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[178] Second, the defensive measures "must be reasonable in relation to the threat posed."[179] This "reasonableness" and "proportionality" inquiry sounds entirely reasonable, and there was great hope that it would be an effective intermediate standard of review lying somewhere in between the deference of the business judgment rule and the rigor of the entire fairness test. But, in the end, it skewed heavily towards the business judgment rule.[180] Moreover, ten years later, in *Unitrin, Inc. v. American Gen. Corp.*,[181] the Delaware Supreme Court would rewrite the *Unocal* test. By noting "a direct correlation between findings of proportionality or disproportionality and the judicial determination of whether a defensive response was draconian because it was either coercive or preclusive . . . ,"[182] the court effectively transformed the second prong of the *Unocal* test from a reasonableness inquiry into a prohibition against draconian measures only. Thus, the *Unocal/Unitrin* standard did not live up to its promise of being a true intermediate standard of review. It turns out that "enhanced scrutiny" is rather deferential after all.[183]

Consider next *Zapata Corp. v. Maldonado*.[184] The case involved a derivative action in which demand had already been excused as futile.[185] Nevertheless, the board created a special litigation committee to consider whether the case should be

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177. *Id.* at 954.

178. *Id.* at 955.

179. *Id.*

180. For a more detailed discussion, see Velasco, *supra* note 7, at 847; *cf.* Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 862 (2006) ("Note how the balance again tips towards authority values even in a context charged with conflicts of interest.").

181. 651 A.2d 1361 (Del. 1995).

182. *Id.* at 1387.

183. *See, e.g.*, Air Prods. & Chem. v. Airgas, 16 A.3d 48, 55 (Del. Ch. 2011) ("[A]s Delaware law currently stands, the answer must be that the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors.").

184. Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

185. *Id.* at 780.

dismissed, and the committee decided that it should.[186] The court had to decide whether the committee's decision should be respected.[187] The court concluded that "an independent committee possesses the corporate power to seek the termination of a derivative suit,"[188] but acknowledged that "there [was] sufficient risk in the realities of [the] situation [—essentially, structural bias—] . . . to justify caution."[189]

The court developed a two-part test for reviewing such decisions. "First, the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions."[190] Second, "[t]he Court should determine, applying its own independent business judgment, whether the motion should be granted."[191] The first prong of this test does some work—although we will consider in the next section exactly how much it really does.[192] The second prong, however, does very little. According to the *Zapata* court, "[t]he second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit."[193] Despite the good intentions of the Delaware Supreme Court, the test it created has not had a significant impact. As a matter of practice, the courts do not tend to uphold a committee's decision under the first prong only to reverse it under the second prong.[194] Thus, the *Zapata* test does little to enhance the duty of loyalty.

Finally, consider the *Kahn* cases, which set forth the standard of review for cases involving transactions with controlling

186. *Id.* at 781.

187. *Id.*

188. *Id.* at 785.

189. *Id.* at 787.

190. *Id.* at 788.

191. *Id.* at 789.

192. *See infra* Part IV.B (considering the difference between the disinterestedness and independence inquiries).

193. Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981).

194. For a rare example of a case in which the second prong was an important part of the analysis, see *Kahn v. Kohlberg Kravis Roberts & Co.*, L.P., 23 A.3d 831 (Del. 2011) (remanding for consideration under the second prong of *Zapata*); *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455 (Del. Ch. 2013) (reversing previous decision to grant motion to dismiss).

shareholders.[195] In *Kahn v. Lynch Comm. Sys., Inc.*,[196] the Delaware Supreme Court held that, when a controlling shareholder has a conflict of interests, approval by fully-informed, independent directors or fully-informed minority shareholders will not invoke the business judgment rule, but only shift the burden of proof on the issue of fairness.[197] The rationale is that, because of the power of the controlling shareholder, we could not trust that the approvals obtained would be fully objective and consensual.[198] The concern goes beyond mere structural bias into a concern that conflicts will not be subject to adequate independent review. More recently, in *Kahn v. M & F Worldwide Corp.*,[199] the Delaware Supreme Court held that if a controlling shareholder obtains the approval of *both* fully informed, disinterested and independent directors *and* fully informed minority shareholders, then the business judgment rule shall apply.[200] The rationale was that the combined procedures provide adequate, and indeed optimal, protection for shareholders.[201] This may very well be the appropriate decision. Nevertheless, it is noteworthy that the intermediate standard of review also found its way back to the business judgment rule.

The point of this section is not to argue the merits of the development of intermediate standards of review. It is merely to note that intermediate standards of review have not panned out as expected. Despite their initial good intentions, courts seem inevitably to find their way back to a deferential standard of review.

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195. Kahn v. Lynch Comm. Sys., Inc., 638 A.2d 1110 (Del. 1994); Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

196. 638 A.2d 1110 (Del. 1994).

197. *Id.* at 1117.

198. *Id.* at 1116–17.

199. 88 A.3d 635 (Del. 2014).

200. *Id.* at 645–47.

201. *See id.* at 644–45 (listing multiple justifications for applying the business judgment rule).

B. Independence

Another promising development has been the courts' willingness to extend the conflicts inquiry beyond mere disinterestedness to include the concept of independence. The concept of "interest" and "disinterestedness" is concerned primarily with direct financial ties: "A director is considered interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders . . . [or] where a corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders."[202] However, the courts are well aware that people can be conflicted by concerns other than money.[203] They have tried to address this gap with the broader inquiry of independence. "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[204] Such an inquiry would seem to hold great promise for strengthening the duty of loyalty substantially. However, the independence inquiry is not quite as robust as it may seem.

It does not, for example, act as a proxy for structural bias.[205] The leading case on the issue is *Beam v. Stewart*.[206] There, the issue was whether the other directors were independent of the controlling shareholder.[207] The court acknowledged the possibility that "[a] variety of motivations, including friendship, may influence the demand futility inquiry."[208] However, the court remained skeptical: "Not all friendships, or even most of them, rise

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202. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993); *see also* Pogostin v. Rice, 480 A.2d 619, 624 ("Directorial interest exists whenever divided loyalties are present, or a director has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders.").

203. *See, e.g.*, *infra* notes 237–238 and accompanying text (discussing non-monetary conflicts of interest).

204. Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984).

205. For a description of structural bias, see *supra* notes 97–99 and accompanying text.

206. Beam v. Stewart, 845 A.2d 1040 (Del. 2004).

207. *See id.* at 1045 ("We now address the plaintiff's allegations concerning the independence of the other board members.").

208. *Id.* at 1050.

to this level . . . ."[209] Only "a particularly close or intimate personal or business affinity" would seem to do so.[210] The plaintiff must persuade the court.[211] Essentially, plaintiffs have to show that "the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."[212] This, of course, flies in the face of structural bias theory. The structural bias argument is not so much that directors are willing to engage in conscious misconduct as that subtle biases make it inappropriate to grant them the deference of the business judgment rule.[213] Because the court rejected the essential premises of structural bias theory, it is not entirely surprising that it would conclude that "[a]llegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' even when coupled with Stewart's 94% voting power, are insufficient, without more, to rebut the presumption of independence."[214]

It turns out that independence amounts to little more than "an inquiry into whether the director's decision resulted from that director being *controlled* by another."[215] Courts typically ask whether directors are "dominated" by[216] or "beholden" to[217] others,

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209. *Id.*

210. *Id.* at 1051.

211. *See id.* at 1050 ("[T]he Court cannot make a *reasonable* inference that a particular friendship does so without specific factual allegations to support such a conclusion."); *see also id.* at 1051 ("The difficulty with structural bias in a demand futile case is simply one of establishing it in the complaint . . . ." (quoting *Aronson*, 473 A.2d at 815 n.8)).

212. *Id.* at 1052.

213. *See* Velasco, *supra* note 7, at 865–70 (explaining the theory of structural bias); *see also id.* at 861

> [S]tructural bias extends much further than conscious discrimination into the realm of semi-conscious, and even unconscious, bias. It is this less-than-conscious aspect that makes structural bias so dangerous and intractable. The claim is not that disinterested directors are dishonest or self-serving; rather, it is that even disinterested directors are not—indeed, cannot be—truly impartial.

214. Beam v. Stewart, 845 A.2d 1040, 1051 (Del. 2004).

215. Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

216. Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988).

217. Rales v. Blasand, 634 A.2d 927, 936 (Del. 1993); Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984).

such that "their discretion would be sterilized"[218] or that they "are incapable of making an impartial decision."[219] As the Delaware Supreme Court recently put it, "[t]he court must conclude that the director in question had ties to the person whose proposal or actions he or she is evaluating that are sufficiently substantial that he or she could not objectively discharge his or her fiduciary duties."[220] These detailed requirements are much more lenient for directors than the standard suggested by the definition of independence, which would seem to require affirmative evidence that "the director's decision is based entirely on the corporate merits of the transaction and is not influenced by personal or extraneous considerations."[221] In a sense, then, independence is little more than a test of indirect interest.

To be sure, the independence inquiry is applied on top of the disinterestedness inquiry, and therefore expands the scope of the duty of loyalty. The courts deserve credit for making this second inquiry. However, in practice, the extension is not nearly as great as it might seem to be. The courts continue to acknowledge too few circumstances that may compromise independence, and demand much too much evidence of such compromise, to make the inquiry into independence very helpful.

C. Capacious Duty of Loyalty

Arguably, something more is happening in corporate law theory. It seems that there may be an inchoate understanding that the duty of loyalty is, or at least should be, much broader than traditional concepts allow. Courts and scholars are increasingly recognizing that directors may be influenced by forces other than money and power, and that loyalty demands more than just the avoidance of conflicts. If so, then there may be promise for a brighter future for a robust duty of loyalty. However, it is not at all clear that any such movement is afoot.

What is the evidence? One could point to developments such

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218. *Rales*, 634 A.2d at 936.

219. *Id.* at 932.

220. Kahn v. M & F Worldwide Corp., 88 A.3d 635, 649 (Del. 2014).

221. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 362 (Del. 1993); *supra* note 204 and accompanying text.

as independence review and the various intermediate standards of review as nascent attempts to effectuate this broader view of the duty of loyalty.[222] In each case, the courts were trying to extend the reach of the duty of loyalty beyond direct financial conflicts. While these developments have certainly helped, we have seen that they have had only limited success.[223]

Another, clearer manifestation of this development was the holding, in *Stone v. Ritter*,[224] that loyalty is not limited to financial conflicts, but extends to actions not taken in good faith.[225] This holding might seem to presage a new era with a more expansive understanding of the duty of loyalty.[226] However, further reflection shows that the holding is not particularly impressive for at least two reasons.

First, the standard of review for bad faith requires the plaintiff to establish intentional misconduct of some sort.[227] This can take many forms,[228] including dereliction of duty,[229] but it must be

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222. *Supra* Part IV.A.

223. *Supra* Part IV.B.

224. 911 A.2d 362 (Del. 2006).

225. *See id.* at 370 ("[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.").

226. *See, e.g.*, Claire A. Hill & Brett H. McDonnell, Stone v. Ritter *and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1778 (2007) (noting that one "consequence [of *Stone*] is the widening of the duty of loyalty. No longer is loyalty only about 'financial or other cognizable fiduciary conflict of interest.' It also includes good faith"); Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 474 n.42 (2007) ("The Delaware Supreme Court's recent *Stone* decision clarifies that bad faith claims implicate a more expansive view of the duty of loyalty.").

227. *See* Velasco, *supra* note 2, at 1250 (describing "intentional misconduct" as "intentional behavior that the law considers to be misconduct").

228. *See Stone*, 911 A.2d at 369

> A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.

(quoting *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006)).

229. *See id.* at 370 ("Where directors fail to act in the face of a known duty to

"more culpable than . . . the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence),"[230] and "requires a showing that the directors knew that they were not discharging their fiduciary obligations."[231] This standard of review is extremely demanding of the plaintiff and deferential to the defendant, and presents a very high obstacle to any actual enforcement of fiduciary duties.

Second, and more importantly, *Stone* added little, if anything, to the law of fiduciary duties. The Delaware Supreme Court had already begun to flesh out the standards for good faith in *In re Walt Disney Co. Derivative Litigation*.[232] What did *Stone* offer? A reconceptualization. Prior to *Stone*, there was a triad of fiduciary duties—care, loyalty, and good faith;[233] after *Stone*, there were only two fiduciary duties—care and loyalty, with good faith being subsumed into loyalty.[234] Despite the rhetoric to the contrary, *Stone* offered no substantive improvement for shareholders; it merely juggled a few labels.

Perhaps the most promising possibility of a future revival of the duty of loyalty comes from the expressions of members of the judiciary, both in dicta and in extra-judicial scholarship, that the duty of loyalty may be greater than we think. A perfect example can be found in the *Disney* case, where the court made the following observation:

> [T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (i.e., preferring the adverse self-interest of the fiduciary or of a related person to the interest

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act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.").

230. *Id.* at 369 (citing *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006)).

231. *Id.* at 370.

232. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006); *supra* note 228 (quoting *In re* Walt Disney Co., Derivative Litig. 906 A.2d 27, 67 (Del. 2006)).

233. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("[A] shareholder plaintiff assumes the burden of providing evidence that directors . . . breached any one of the *triads* of their fiduciary duty—good faith, loyalty, or due care.").

234. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (characterizing good faith as a "subsidiary element" within the fiduciary duty of loyalty).

> of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision. To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed.[235]

Lofty language such as this certainly seems to aspire to great things. However, in that case, the court settled upon the duty to act in good faith as the vehicle to address the violations at hand.[236]

Similar language can be found sprinkled throughout the law reports. Among my personal favorites are the following two passages. The first is an often-cited gem by former Chancellor Allen: "Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, . . . shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation."[237] The second is a similar passage by then Vice Chancellor Strine:

> Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. Homo sapiens is not merely homo economicus. We may be thankful that an array of other motivations exist that influence human behavior; not all are any better than greed or avarice, think of envy, to name just one. But also think of motives like love, friendship, and collegiality, think of those among us who direct their behavior as best they can on a guiding creed or set of moral values.[238]

When writing or citing passages such as these, courts are implicitly acknowledging the need for a more comprehensive inquiry into loyalty than current law allows. And yet, we are where we are—which, as I have argued throughout this article, is not where we

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235. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 1993).

236. *See id.* ("A vehicle is needed to address such violation doctrinally, and that doctrinal vehicle is the duty to act in good faith.").

237. *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) (Allen, C.). This passage is especially well-cited for what is ostensibly an unpublished opinion.

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

seem to think we should be. Perhaps the courts are simply content to act "more as preachers than as policemen."[239] If so, then hope for legal change is misplaced.

On the other hand, perhaps there is some hope after all. The elevation of Leo Strine from Vice Chancellor to Chancellor and then to Chief Justice of the Delaware Supreme Court is not insignificant. Throughout his judicial career, Strine has been more receptive to softer loyalty claims, such as structural bias, than many of his colleagues. He is now in a position to have a major influence on corporate law. Perhaps his loyalty-friendly views will find their way into Delaware jurisprudence.

Insight into Strine's views on the duty of loyalty can be found in a law review article that he co-authored, entitled *Loyalty's Core Demand*.[240] There, he forcefully articulates capacious understanding of the duty of loyalty that "emphasizes not only the obligation of a loyal fiduciary to refrain from advantaging herself at the expense of the corporation but, just as importantly, to act affirmatively to further the corporation's best interests."[241] The breadth of this view can be seen in his claims that "the duty of loyalty is implicated by all director actions"[242] and that "it is possible to conceive of there being only one core [fiduciary] duty, that of loyalty, and that the duty of care is itself simply a component of what is expected of a faithful—that is, loyal—fiduciary."[243] As for the prominence that financial conflicts have enjoyed in loyalty jurisprudence, Strine "acknowledge[s] that the duty of loyalty remains. . . . most difficult to apply to circumstances when directors act without an apparent selfish interest to injure the corporation."[244] However, he treats this as a bug, rather than a feature, of the duty of loyalty. To be fair, the article is concerned primarily with defending the holding of *Stone v. Ritter* and not with expanding loyalty beyond good faith. However, the seeds for greater expansion arguably are present.

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239. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997).

240. Strine et al., *supra* note 53. For the sake of simplicity, I will refer only to Strine, and not his coauthors, when discussing this article.

241. *Id.* at 634.

242. *Id.*

243. *Id.* at 635.

244. *Id.* at 634.

But, is Strine a policeman, or is he content to be a preacher? There are cases that suggest that he may be willing to decide cases consistent with his theories. Two cases in particular come to mind.

The first example is the *Oracle*[245] case. In that case, plaintiffs were pursuing derivative litigation against the directors of the company (the Trading Defendants).[246] Oracle created a special litigation committee (SLC) to decide whether derivative litigation should be dismissed.[247] The company appointed two new board members, both of whom were tenured faculty members at Stanford University, to comprise the SLC.[248] After an investigation that was, "by any objective measure, extensive,"[249] the committee concluded that the litigation should be dismissed.[250] The question was whether their decision should be respected.[251] Strine

> conclude[d] that the SLC [had] not met its burden to show the absence of a material factual question about its independence . . . because the ties among the SLC, the Trading Defendants, and Stanford [we]re so substantial that they cause[d] reasonable doubt about the SLC's ability to impartially consider whether the Trading Defendants should face suit.[252]

The problem was that the Trading Directors were "a fellow professor and two large benefactors of their university."[253]

In order to understand the significance of the holding, one needs to contextualize the facts. The financial ties between the Trading Defendants and the SLC members were indirect at best, with the former representing donors and potential donors of Stanford University, where the latter were employed.[254] The court acknowledged that neither SLC member "ha[d] fundraising responsibilities at Stanford."[255] Moreover, the Trading Defendant

245. *In re* Oracle Corp. Derivative Litig., 824 A.2d 917 (Del. Ch. 2003).
246. *Id.* at 922.
247. *Id.* at 923.
248. *Id.* at 923–24.
249. *Id.* at 925.
250. *Id.* at 928.
251. *Id.* at 920.
252. *Id.* at 942.
253. *Id.* at 921.
254. *See id.* at 920–21 (describing the financial ties between the defendants and committee members).
255. *Id.* at 936.

who was a fellow professor "was in a different academic department from either SLC member."[256] The most that could be said of the relationship between the professor defendant and one of the SLC members was that the former "was a professor who had taught [the latter] and with whom he had maintained contact over the years."[257] This is not exactly evidence of a close friendship.

As for the SLC members' independence, the court acknowledged that "neither of the SLC members is compromised by a fear that support for the procession of this suit would endanger his ability to make a nice living."[258] In fact, Strine admitted that "[n]othing in the record suggest[ed] . . . that either [SLC member was] dominated and controlled by any of the Trading Defendants, by Oracle, or even by Stanford."[259] Although that is ordinarily considered the appropriate criteria,[260] Strine sought to move the needle beyond those limitations.[261] He was not convinced of the SLC members' independence, even though one imagines that many of his judicial colleagues would be. Chief Justice Veasey, for example, found the directors in *Beam v. Stewart*[262] to be independent despite what seemed to be considerably stronger ties to the defendant.[263] Although one could distinguish the cases based on who bears the burden of proof, as Veasey tries to do, it seems that he is not entirely convinced.[264] In any event, Strine's views on independence, friendship, and structural bias are undeniably quite

256. *Id.* at 942.

257. *Id.*

258. *Id.* at 930.

259. *Id.* at 937.

260. *See supra* notes 215–221 and accompanying text (discussing the standard for independence).

261. *See In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 937 (Del. Ch. 2003) ("But, in my view, an emphasis on 'domination and control' would serve only to fetishize much-parroted language, at the cost of denuding the independence inquiry of its intellectual integrity."); *see also supra* note 237 and accompanying text (discussing various factors that could compromise a director's independence).

262. 845 A.2d 1040 (Del. 2004).

263. For a discussion of the case, see *supra* notes 205–214 and accompanying text.

264. *See Stewart*, 845 A.2d at 1054–55 ("We need not decide whether the substantive standard of independence in a SLC case differs from that in a presuit demand case. As a practical matter, the procedural distinction relating to the diametrically-opposed burdens . . . may be outcome determinative on the issue of independence.").

different than Veasey's, and this could be expected to lead to very different outcomes in actual cases.

A second, more recent example can be found in *Delaware County Employees Retirement Fund v. Sanchez*.[265] That was another independence case. Strine, now Chief Justice, held that the long-term friendship in that case, at least when joined with strong financial ties, could compromise director independence.[266] This is a promising development after the *Stewart* case. However, not too much should be made of the *Sanchez* opinion. As skeptical as the *Stewart* court seemed of structural bias, the opinion in that case had acknowledged that "a particularly close or intimate" friendship could compromise director independence.[267] The relationship in the *Sanchez* case had spanned over fifty years![268] Arguably, the two cases are perfectly compatible. Thus, *Sanchez* cannot fairly be said to rewrite the law of independence in the way that *Oracle* might have. Nevertheless, it is a positive development to see Strine so quickly hold what Veasey would only say was theoretically possible.

As welcome as these cases may be, they are not game-changing. They are not enough to establish that a revolution is on its way. In fact, one should not forget that Strine also proposed the test that was eventually adopted in the *M & F Worldwide* case, which gave controlling shareholders access to the business judgment rule.[269] Arguably, this is a more distressing development for loyalty advocates than the *Oracle* and *Sanchez*

265. Del. Cty. Emps. Ret. Fund v. Sanchez, 124 A.3d 1017 (Del. 2015).

266. *See id.* at 1019 ("[N]ot only that the director [did have] a close friendship of over half a century with the interested party, but that consistent with that deep friendship, the director's primary employment . . . was as an executive of a company over which the interested party had substantial influence.").

267. *See Stewart*, 845 A.2d at 1050–52 (describing that a close personal relationship will be considered in the calculus, but "substantially more" must accompany it).

268. *See Sanchez*, 124 A.3d at 1023 ("[T]here arises a pleading stage inference that Jackson's economic positions derive in large measure from his 50-year close friendship with Chairman Sanchez . . . .").

269. *Supra* notes 94–95 and accompanying text. Strine proposed this test in *In re Cox Commc'ns Inc. S'holders Litig.*, 879 A.2d 604, 606, 643–45 (Del. Ch. 2005). Also worth mentioning is Strine's authorship of the opinion in *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), which strongly endorsed the application of the business judgment rule after a shareholder vote, rejecting the plaintiffs' argument that there was a de facto controlling interest.

cases are promising. Therefore, although one might not be considered foolish for holding out hope, it does not seem fair to say that a more capacious duty of loyalty has gained any real traction as of yet.

V. The Way Forward

In this Article, I have sought to demonstrate that the corporate law duty of loyalty is significantly weaker than is generally appreciated. I listed various developments that have cut back on its enforcement significantly, and then argued that other developments that might have mitigated these effects have not lived up to their potential. As a result, we are left with a severely diminished duty of loyalty.

I do not mean to suggest that these developments have been entirely misguided. I would readily concede that most of them are justifiable—perhaps even desirable—when considered individually. Rather, my argument is that the accretion of various restrictions has led to a situation in which enforcement of the duty of loyalty is out of sync with corporate law theory and the prevailing corporate law narrative. This should give us reason to wonder whether we have reached a point that is suboptimal. It certainly raises the question of what ought to be done about it.

In this Part, I will suggest there are three possible strategies. First, the law could scale back on some of the developments in order to achieve a more optimal balance.[270] Second, the law could keep the existing rules, but develop alternative solutions to help mitigate their negative effects.[271] Third, the law could do nothing and accept the legal status quo.[272] I will briefly address each of these strategies, but I will not attempt to offer a comprehensive solution. The point of this Article is to identify an inconsistency between law and theory. A thorough reassessment of corporate law and theory is called for, and that would be beyond the scope of this Article. Ultimately, the way forward will depend more upon policy choices than logic. If we accept the prevailing corporate law

270. *Infra* Part V.A.
271. *Infra* Part V.B.
272. *Infra* Part V.C.

narrative, then we should adopt some mix of the first and second strategies in order to have the law reflect the theory. On the other hand, if we accept the status quo, then we need to revise our theories to explain corporate law.

A. Option 1: Scale Back

The first option would be to scale back on the various developments discussed in Part III. A radical revision or wholesale repeal of modern developments may not be necessary. Proceeding under the assumption that each individual development was justified but the aggregate effect is excessive, it would seem that a more modest scaling back, or tweaking of the rules, would be appropriate.

Legal reform could take different approaches. It could concentrate on eliminating rules that are particularly detrimental. Alternatively, it could focus on scaling back various rules to achieve a better equilibrium. Of course, a combination of the two strategies might be the best approach. There is no obviously superior path. Although a specific proposal would be beyond the scope of this Article, I would like to offer some thoughts on the matter.

Any legal reform in this area should be based on a cost-benefit analysis. An important aspect of such an analysis would be to weigh the risk of Type I errors (false positives) against that of Type II errors (false negatives) in litigation.[273] The meaning of false negative is fairly clear: restrictions on enforcement increase the risk that breaches of duty will be permitted. The meaning of false positive is a bit more complicated: allowing more enforcement actions not only increases the risk of finding a breach of duty where there is none, but also increases litigation costs in the absence of breach and causes some businesses to forego positive opportunities for fear of litigation.

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273. *See generally* Kenneth B. Davis, *Judicial Review of Fiduciary Decisionmaking—Some Theoretical Perspectives*, 80 NW. U. L. REV. 1 (1986); Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711 (1996). False negatives and false positives have not been labeled consistently in the literature. I have chosen to use Professor Stout's convention of referring to false positives as Type I errors and false negatives as Type II errors.

Ideally, we would want to minimize the aggregate costs of all errors.[274] However, it is not easy to get precise estimates of these costs. In the absence of reliable data, it may be wise to seek reasonable alternatives. For example, it may be advisable to concentrate on reforming rules that add the greatest costs or the least value, or those rules that would be easiest to change and offer reasonable potential.

A thorough cost-benefit analysis would be complicated by the necessity of factoring in the cross-effects that the various rules have on one another. By way of illustration, I will explore exculpation provisions. These are charter provisions that limit or eliminate director liability for monetary damages for breaches of the duty of care.[275] Although exculpation provisions do not apply to breaches of the duty of loyalty, they can demonstrate the impact of seemingly unrelated developments.

Exculpation provisions were born out of a Type I error crisis. In *Smith v. Van Gorkom*,[276] the Delaware Supreme Court held the directors liable for breach of the duty of care under circumstances that many would not even consider ordinary negligence, much less gross negligence.[277] That decision undermined confidence in the deference offered by the business judgment rule, and some sought a means to do away with liability for breach of the duty of care altogether. In order to eliminate the risk of false positives, legislators were willing to accept the cost of all false negatives. That was not necessarily a mistake, but the decision is striking enough to give one pause. The cost of Type II errors would have to be quite high to outweigh the full cost of Type I errors in every

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274. *Cf.* Melvin Aron Eisenberg, *Bad Arguments in Corporate Law*, 78 GEO. L.J. 1551, 1553 (1990) ("Unlike the social sciences . . . in applied enterprises the costs of a Type I error may be just as great or greater than the costs of a Type II error."). *But see* Davis, *supra* note 273, at 29 ("[I]f the fiduciary is in a better position to obtain compensation for the risk of Type II error than the principal is in to obtain compensation for the risk of Type I error, rule *B* might be the 'better' rule, despite the greater aggregate amount of error.").

275. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2017); MODEL BUS. CORP. ACT ANN. § 2.02(b)(4) (AM. BAR ASS'N 1969).

276. 488 A.2d 858 (Del. 1985).

277. *See* Velasco, *supra* note 8, at 658 ("Although the Supreme Court reaffirmed that the standard of review was gross negligence, they held directors liable under circumstances that many people did not believe amounted to gross negligence, and some thought did not even amount to simple negligence.").

meritorious case. This is especially so because the business judgment rule already provided very strong protection against false positives.[278] The added protection of an exculpation provision was likely quite minimal, and therefore not obviously worth the cost of preventing recovery in all meritorious cases.[279]

It may be that exculpation makes sense in duty of care cases. However, it is far less likely to make sense in duty of loyalty cases. That is because self-dealing is potentially so very lucrative for a fiduciary. This much is easily understood. What is less often appreciated is the impact of exculpation provisions on loyalty cases. Because of exculpation, there is little to no risk of Type I errors for care cases. Thus, the justification for the restrictions on derivative litigation must be based almost entirely on the risk of Type I errors in loyalty cases. It seems difficult to imagine that the cost-benefit analysis does not at least change dramatically when care cases are eliminated.

This suggests that a reassessment of the restrictions on derivative litigation would have been appropriate after the widespread acceptance of exculpation provisions. However, such a reassessment never occurred. Exculpation provisions were simply accepted over and above all previous developments. While a careful review might show that this was ultimately appropriate, that seems unlikely if things were otherwise previously in balance. At the very least, this example illustrates how new developments could have significant ramifications beyond their immediate scope and therefore should be evaluated not simply on their own merits, but also in relation to the entire constellation of rules that make up corporate law. Alternatively, periodic reassessment of the overall situation would be appropriate.

Keeping in mind that the goal of this section is only to present the option of scaling back and not to recommend a specific course of action, it seems possible to venture guesses as to which types of reforms are more promising than others. Thus, for example, I will suggest that corporate law would be less willing to scale back on disinterested review or the demand requirement than it would be

278. *See supra* notes 47–52 and accompanying text (discussing the protection offered by the business judgment rule).

279. One should also factor in the possibility that directors, once they know they are entirely free of liability for breach of the duty of care, may be more likely to be negligent than they would have been if there were a risk of liability.

to revitalize the entire fairness test. In the remainder of this section, I will survey the various types of developments considered in Part III.

The first set of developments involved the approval of conflicted transactions by disinterested directors.[280] These rules could be scaled back in different ways. An extreme reform could reject the cleansing power of disinterested director approval; a more moderate reform could reduce the cleansing power of such approval.[281] The strongest theoretical argument in favor of such reforms is that they directly tackle an important problem—that of structural bias, which undermines confidence in directors which is the prerequisite for the deference of the business judgment rule.[282] Moreover, it is worth noting that such reforms would not be entirely revolutionary, but simply would amount to turning back the clock and returning to earlier policies.[283]

It is not obvious how a cost-benefit analysis would come out. Not allowing disinterested directors to sanitize conflicted transactions could lead to a great deal of litigation, which could mean a huge increase in Type I errors. However, it could also lead to a great reduction in conflicted transactions. This would reduce Type II errors, but possibly increase Type I errors in the form of positive opportunities foregone. These are empirical questions; theory cannot provide answers.

Nevertheless, it seems that this type of reform would not gain much traction. It would fly in the face of modern trends. The heart of corporate law theory is that conflicts should be decided by neutral arbiters,[284] and one of the main themes of modern theory is that unconflicted directors can be neutral arbiters.[285] In fact,

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280. *See supra* Part III.A (discussing the development of disinterested review to deal with the duty of loyalty).

281. A related proposal would be to expand what counts as an "interest," and thereby tighten the disinterestedness requirement. However, that is essentially the role of the independence inquiry, which is considered separately. For an example, see *infra* notes 300–301 and accompanying text.

282. *See supra* notes 96–99 and accompanying text (discussing structural bias).

283. *See supra* note 25 and accompanying text (summarizing Professor Marsh's history of the development of the duty of loyalty between 1880 and 1960).

284. *See supra* notes 70–73 and accompanying text (explaining the need for an independent decision maker).

285. *See generally supra* Part III.A.

unconflicted directors are preferable to judges because judges are not business experts.[286] Thus, both state and federal law has concentrated on ensuring that disinterested directors be neutral arbiters rather than on denying that they can be.[287] Even if one is convinced about the merits of scaling back on disinterested approvals, it seems overly-optimistic to expect the law to reverse course on such a fundamental question. Thus, this does not seem to be a promising option.

The second category of potential reforms is the cognizability of conflicts for duty of loyalty purposes.[288] Currently, only personal or familial financial conflicts that are material are deemed to rise to the level of self-dealing count.[289] This could be scaled back in a number of ways. For example, the materiality standard could be eliminated or lowered so that less significant financial conflict would be captured. Alternatively, important non-financial conflicts, such as those involving extended family members or close friends or important causes, could be recognized as raising loyalty issues.

This seems to be a more promising avenue for reform. After all, the restrictions seem to be based more on practical business considerations than on fiduciary law principles. Therefore, compromise seems both more reasonable and more achievable. Moreover, expanding the scope of cognizability could be done in a very moderate way that need not upset the fabric of corporate law. For example, the materiality standard, which is arguably quite high, could be lowered to something closer to a *de minimis* exception: insignificant amounts could be ignored, while significant amounts would matter even if they would not qualify as material to the director. After all, people are known to sometimes do foolish things for relatively small amounts of money.

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286. *See* Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1288 (1982) ("There is no reason to believe that courts can systematically improve on the business decisions made by corporate managers."); *see also* Velasco, *supra* note 8, at 660–61 (discussing judicial incompetence).

287. *See, e.g.*, Sarbanes–Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1 (2012); Dodd–Frank Act of 2010 § 952, 15 U.S.C. § 78j-3 (2012); DEL. CODE ANN. tit. 8, § 144 (West 2017); *see also* N. Y. Stock Exch., Inc., Exchange Act Release No. 34-48745, 81 SEC Docket 1586 (Nov. 4, 2003) (describing exchange listing rules).

288. *See generally supra* Part III.B.

289. *See supra* Part III.B (analyzing which types of conflicts of interests are cognizable).

Consider Martha Stewart, who was embroiled in an insider trading scandal and convicted of making false statements to investigators, all regarding a sale of approximately $230,000 worth of stock—an amount that is not insignificant, but one that would not be considered material relative to her fortune.[290] In a similar manner, one could reasonably maintain friendship is such a powerful force that people might do things for friends that they would not do for money.[291] Thus, strong affinities could compromise confidence in director's objectivity sufficiently to rebut the presumption of the business judgment rule.

Drawing lines would be difficult, but should not be impossible. The cost-benefit analysis would depend entirely on where those lines are drawn. There is no reason to assume that the status quo has achieved the optimal balance. However, it seems unlikely that the ideal point is very far from the status quo. Extending the scope of enforcement too far along these lines would likely lead to huge increases in Type I costs—or, at least, one could easily imagine. Thus, it would be prudent to move slowly on this front.

A third category of potential reform would involve strengthening the entire fairness test. As previously discussed, corporate law seems to be moving from a form of strict scrutiny to a more relaxed test that aspires only to a range of fairness.[292] Reform would involve reverting to a more rigorous form of judicial review, in which there is less room for error and doubts are resolved in favor of the shareholders.

This seems to be the most promising avenue for reform. In the first place, the relaxation of the fairness test is still underway, and much less established than the other developments.[293] Reform is

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290. *See* United States v. Stewart, 433 F.3d 273, 283 (2d Cir. 2006) ("Stewart's ImClone sell order . . . yield[ed] proceeds of approximately $230,000.").

291. *See* Velasco, *supra* note 7, at 859 n.157 (discussing incommensurability of friendship and money) (citing Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779, 785–86 (1994)); *see also* Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 239 (2009) ("[D]irectors may in some circumstances be systematically biased for many other reasons besides family and finance. It will come as no surprise that people are also biased by group loyalties, friendship, and nonpecuniary self-interest.").

292. *See generally supra* notes 120–124 and accompanying text.

293. *See generally supra* Part III.C. It is not clear that the courts would even acknowledge that the "range of fairness" is different than "entire fairness."

likely to be less painful. Moreover, a cost-benefit analysis is likely to be supportive. The costs of Type I errors are relatively low by the time the entire fairness test comes into play. By that point, there is a well pleaded case of self-dealing and a trial already underway. It would at most be suboptimal, but not a true injustice, to rule against the transaction that arguably might better have been forbidden altogether. By comparison, the costs of Type II errors are quite high at this point: the possibility of disloyal conduct that goes undetected is likely at its zenith.

Moreover, such reform would resonate well with corporate law theory. The extreme deference of the business judgment rule that is given to directors when they can be trusted ought to be balanced by a rigorous entire fairness test when directors cannot be trusted.[294] This would seem, then, to be the low-hanging fruit of possible reforms.

The fourth category of reform would be the standing rules for maintaining derivative litigation.[295] Because there are so many restrictions, there are a wide range of potential reforms. Reform could target, for example, the contemporaneous ownership rule, the demand requirement itself, the particularity requirement, access to information or discovery, the waiver rules, or special litigation committees.[296] Any or all of them could be eliminated, or merely scaled back.

A cost-benefit analysis on this front would be a tremendous undertaking. Nevertheless, a few general observations are possible. It seems that the demand requirement may be too integral to the courts' understanding of corporate law theory to be eliminated or radically revised. Moreover, eliminating the demand requirement would not eliminate the need for demand futility analysis: it might be restyled as the standard of review for derivative litigation, but the need to decide when shareholders are permitted to bring such an action would not change. By comparison, lowering the burden of the particularity requirement

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294. *See supra* Part II.B (discussing the prevailing corporate law narrative).

295. *See generally supra* Part III.D.

296. *See, e.g.*, *supra* notes 137–141 and accompanying text (discussing the contemporaneous ownership rule); *supra* notes 142–146 and accompanying text (discussing the demand requirement); *supra* notes 147–148 (describing the particularity requirement); *supra* notes 149–151 and accompanying text (noting other difficulties in bringing derivative actions).

and increasing plaintiffs' access to information should be less problematic. It may well be possible to scale back on these rules in ways that would not allow the costs of Type I errors to swamp the benefits of reducing Type II errors. Moderate moves along these lines might do more good than harm.

The final category of reform would involve corporate opportunity waivers.[297] Such laws could be repealed altogether. Alternatively, they could be scaled back to require shareholder approval, whether by charter amendment or shareholder-adopted bylaw.[298] However, the empirical evidence does not suggest that reform is necessary.[299] The reasons for doing so are based in theory and principle. It seems implausible to expect reform on this basis alone.

I would like to offer one final thought on the option of scaling back. After a thorough reassessment of the legal landscape, and a careful weighing of the various costs and benefits, it may be decided that scaling back on modern developments is not appropriate after all. Nevertheless, the foregoing discussion could inform future developments of law. Even if we decide not to reverse any of the developments, we could decide to stop, or at least scale back the rate of, future changes along the same lines. If nothing else, this section should suggest that future changes ought to be evaluated not only on their own merits, but also on the overall effect they will have on corporate law.

B. Option 2: Balance

One way to respond to the diminishing duty of loyalty is to scale back on modern developments, as discussed in the previous section. A second approach would be to pursue alternative

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297. *See generally supra* Part III.E.

298. Requiring a shareholder-adopted bylaw might be preferable. If waiver requires a charter amendment, then repeal of the waiver would also require a charter amendment. It might be difficult to get directors to agree to such a repeal. *Cf.* Velasco, *supra* note 8, at 659 (making similar argument with respect to exculpation provisions).

299. *See supra* note 168 and accompanying text (highlighting empirical evidence that suggests that widespread use of corporate opportunity waivers may not be harmful to shareholders).

strategies for mitigating the situation. This section will briefly consider some of the possibilities.

Perhaps the obvious choice would be to work with strategies that have already been attempted. Part IV considered some of these: intermediate standards of review and independence review. Such strategies could fairly easily be revitalized to produce stronger results. This would not necessarily even require rewriting much case law. To employ the language of Delaware Chief Justice Strine, employing a "gimlet eye"[300] or a different "flavoring"[301] might be sufficient to effect the appropriate change. In other words, existing tests could help mitigate the situation if only they were applied with greater sympathy for loyalty concerns.

I believe that improving the intermediate standards of review and independence review would be excellent ways to deal with the concerns raised in this Article. Thus, in previous work, I have argued for a unified intermediate standard of review for dealing with issues of structural bias.[302] Nevertheless, I will not spend much time on these strategies for two reasons. First, such reforms are relatively straightforward and, for present purposes, require little elaboration. Second, there is reason to question their ultimate success. If these developments failed to live up to their full potential the first time, there is reason doubt whether they would have a lasting impact on a second attempt. Courts seem to have difficulty with muscular intermediate standards of review and with taking on structural bias. If so, then it might be better to pursue alternative strategies for meaningful reform.

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300. Chesapeake Corp. v. Shore, 771 A.2d 293, 323 (Del. Ch. 2000). As Strine explained:

> If Unocal is applied by the court with a gimlet eye out for inequitably motivated electoral manipulations or for subjectively well-intentioned board action that has preclusive or coercive effects, the need for an additional standard of review is substantially lessened. Stated differently, it may be optimal simply for Delaware courts to infuse our Unocal analyses with the spirit animating Blasius and not hesitate to use our remedial powers where an inequitable distortion of corporate democracy has occurred.

Id.; *see also* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1316 (2001) (same) (quoting *Chesapeake Corp.*, 771 A.2d at 323).

301. Allen et al., *supra* note 300, at 1315.

302. *See* Velasco, *supra* note 7, at 870–83 (discussing the limits of director independence).

Another possibility for dealing with a diminished duty of loyalty would be to strengthen its counterpart, the duty of care. The duty of care is an important, but under-enforced fiduciary duty.[303] Courts often suggest that the deference of the business judgment rule makes sense because unconflicted directors can be trusted.[304] If the duty of loyalty adequately weeded out conflicts of interest, that might well be so. But if the duty of loyalty fails to do so adequately, then we cannot justify so much deference. As I have argued in the past, "the fact that a shareholder cannot establish self-dealing does not mean that directors were not conflicted[.]"[305] The upshot of all the developments in Part III is that judicial failure to find a breach of the duty of loyalty is no guarantee that there has not been such a breach. Thus, the need for enforcement of the duty of care remains. This does not mean that strict enforcement is appropriate, but it does suggest that no enforcement may be inappropriate.

How could the duty of care be strengthened? One possibility would be to eliminate exculpation provisions. Exculpation provisions relieve directors of any possibility of liability for breaches of the duty of care.[306] Eliminating them would not be so radical as it might seem, because the business judgment rule would remain. The business judgment rule shields directors from liability for breaches of duty of care in all but the most extreme circumstances.[307] Directors are not liable for negligence or unreasonableness, but only for gross negligence and irrationality.[308] In fact, very few cases exist in which directors have been held liable under these standards.[309] Thus, eliminating

303. *See* Velasco, *supra* note 8, at 648 (describing "the duty of care as it currently exists in corporate law" as "deliberately and advisedly underenforced, but not entirely unenforced"); *see also* Julian Velasco, *The Role of Aspiration in Corporate Fiduciary Duties*, 54 WM. & MARY L. REV. 519, 580–85 (2012) (discussing the concept of the underenforced duty).

304. *See generally supra* notes 7, 70–73 and accompanying text.

305. Velasco, *supra* note 2, at 1255.

306. *See generally supra* note 275 and accompanying text.

307. *See generally supra* notes 47–52 and accompanying text.

308. *See generally supra* notes 50–51 and accompanying text.

309. *See, e.g.*, Joseph W. Bishop, *Sitting Ducks and Decoy Duck: New Trends in the Identification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099–1100 (1968) (noting four examples "based on extensive (although not exhaustive) investigation"); Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial*

exculpation provisions and reverting to the business judgment rule would have only a minor effect on actual litigation outcomes. However, by restoring the theoretical possibility of liability, it could have a real effect on director behavior.[310]

Admittedly, elimination of exculpation provisions is highly unlikely. Not only are they ubiquitous, but in addition there is no strong push for repeal.[311] Nevertheless, complete repeal is not the only option. The duty of care could be strengthened by making it easier for exculpation provisions to be repealed. Generally, exculpation provisions reside in the corporate charter.[312] They can be repealed, but that requires a charter amendment. Shareholders cannot amend charters on their own; the approval of both the shareholders and the directors is required.[313] Directors are unlikely to vote in favor increasing their potential liability. Thus, exculpation provisions are effectively locked into the corporate governance system. To make them easier to repeal, the law could provide that exculpation provisions could be adopted and repealed by shareholder-enacted bylaw.

There is no reason to believe that this would result in a mass repeal of exculpation provisions. Shareholders seem to be aware of the risks that would be entailed by repeal. Moreover, it is not very easy for shareholders to coordinate on action to amend bylaws.[314] By comparison, if a mistake were made, it would be relatively easy, as a procedural matter at least, for directors to get shareholders to

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Avoidance of Standards and Sanctions Through the Business Judgment Rule, 62 TEX. L. REV. 591, 591 n.1 (1983) (collecting seven cases); *see also* RADIN, *supra* note 88, at 498–503 (discussing fourteen cases).

310. *Cf.* Velasco, *supra* note 8, at 663–66 (discussing extent of director risk aversion).

311. *See* Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 659–60 (2002) (discussing lack of interest in repeal of exculpation provisions). *But see* Velasco, *supra* note 8, at 659 (discussing limits of Rock & Wacther's argument).

312. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2017) (allowing charters to include exculpation provisions).

313. *See id.* § 242 (outlining the charter amendment process).

314. *See* L. John Bird, *Stockholder and Corporate Board Bylaw Battles: Delaware Law and the Ability of a Corporate Board to Change or Overrule Stockholder Bylaw Amendments*, 2008 U. PENN. J. BUS. LAW 217, 235–36 (2008) (discussing the difficulties shareholders face in amending corporate bylaws including apathy and failure to collectively act).

vote for the restoration of exculpation. Under these circumstances, the flexibility would seem ideal. It would provide little more than the threat of a threat of liability in most cases, while allowing shareholders to choose to protect themselves with a stronger duty of care if they deem it necessary.

Another possibility would be to increase shareholder voting rights. This could be done in a myriad of ways. For example, the number of issues on which shareholders are entitled to vote could be increased. Unless the issues were carefully chosen, however, this could easily slide into a shareholder rights issue (to increase shareholder power generally) rather than a duty of loyalty issue (to deal with conflicts specifically). In order to preserve the prerogative of un-conflicted directors to manage the business and affairs of the corporation, shareholders could be given extended rights to vote only on conflicted transactions and other issues that clearly implicate loyalty issues—an example of which might be "say on pay."[315] Although this would entail transaction costs that are not insignificant, it would enable shareholders to protect themselves to the extent they wish to do so.

It may be that increasing shareholder voting rights would fail a cost-benefit analysis. Alternatively, it might be thought to undermine too much some of the key advantages of the corporate form—the separation of ownership and management and the benefits of expert management.[316] However, substantive voting rights are not the only way to increase shareholders' ability to protect themselves. Federal law has devised a number of

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315. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376 (2010) (codified at various sections of the U.S.C.). Of course, even when limited to issues touching upon loyalty, shareholder voice may have a significant impact on management decision making. Thus, for example, executive compensation is a quintessential business decision. *See Brehm v. Eisner*, 746 A.2d 244, 263 (2000) ("[T]he size ad structure of executive compensation are inherently matters of judgment.").

316. *Cf.* Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1276-77 (1982)

> The genius of the modern corporation . . . is that it enables individuals who have wealth but lack managerial ability to invest while simultaneously allowing professional managers who lack personal wealth to run enterprises. Shareholders would be hurt rather than helped if they were given more power, which no doubt explains why they show no enthusiasm for the constant proposals to increase their role.

interesting alternatives that could be incorporated in state law. Using proxy rules as a model, for example, shareholders could be given non-binding voting rights.[317] Using Dodd–Frank as a model, shareholders could be given the right to vote on whether their voting rights should be extended.[318] Other possibilities could be imagined to achieve a proper balance.

A different approach would be to strengthen the shareholders' existing right to vote for and against directors. Although it would be controversial, such a move would fit in nicely with corporate theory.[319] As the courts have often acknowledged, "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[320] Moreover, there have been some movements along these lines, both in state law and federal law.[321] Of course, there are also valid objections to strengthening shareholder voting power.[322] But those concerns

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317. *See* 17 C.F.R. § 240.14a-8(i)(1) (2017) (allowing shareholder proposals that would otherwise be considered improper under state law to be included in the company's proxy materials if they are cast as recommendations or requests).

318. *See id.* § 14A(a)(2) (requiring a periodic shareholder vote to determine the frequency of shareholder votes on executive compensation packages).

319. *See* Bo Becker & Guhan Subramanian, *Improving Director Elections*, 3 HARV. BUS. L. REV. 1, 21 (2013)

> To disinterested observers, the idea that shareholders should be able to put their own nominees on the company's proxy statement might seem to require no explanation. (As one prominent Delaware lawyer put it to us, proxy access might even seem to be a property interest that comes with share ownership.) Yet proxy access has been one of the most controversial—if not the most controversial—issues in corporate governance over the past decade.

320. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); *see also* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) ("[T]he stockholder franchise has been characterized as the 'ideological underpinning' upon which the legitimacy of the directors managerial power rests." (quoting *Blasius*, 564 A.2d at 659)).

321. For an example from federal law, see *supra* note 318 and accompanying text. For examples from state law, see DEL. CODE ANN. tit. 8, §§ 112–113 (West 2017).

322. For a sampling of arguments against extending shareholder voting power, see generally Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006); Leo E. Strine, *Towards a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759 (2006).

should prompt us to act carefully, rather than to take voting rights off the table entirely. For present purposes, it suffices to note that stronger rights to elect and remove directors would empower shareholders to engage in self-help and protect themselves from the abuse at the hands of directors that could result from a diminished duty of loyalty.

C. Option 3: Do Nothing

A third and less obvious way to respond to the diminishing duty of loyalty is to accept the legal status quo and do nothing. This is an option that should not be rejected outright. There are various reasons why this might be appropriate. Most obviously, if each individual development was worthwhile, then of course all of them taken together may be appropriate, as well. It is also possible that, although the status quo is imperfect, any identifiable fixes would be more costly than beneficial. Alternatively, one might reasonably believe that the controversial nature of the issue makes real reform politically impossible. Change is by no means a foregone conclusion.

The point of this Article has not been to insist otherwise. Rather, it has been to point out an important fact that may not be obvious: that the duty of loyalty has been consistently watered down over the years to the point where it is but a shadow of its former self. Standing alone, this fact would not necessarily be problematic: laws often change, even drastically. What makes it problematic is that the corporate law theory seems to depend upon a robust duty of loyalty, and that the prevailing narrative assumes that we have it. If the actual law does not match our understanding of it, then something is definitely amiss.

This is why I have called for a reassessment of the legal status quo. We should not assume that everything is fine as is, although we cannot rule it out, either. After a thorough review, we may decide that the status quo is roughly optimal after all. If so, however, the disconnect between the theory and the practice remains problematic. I submit that if no change to the law is going to be made, then we still need to rethink corporate law theory and revise the prevailing narrative. We ought not to perpetuate the mistaken notion that the duty of loyalty is enforced strictly.

Candor is essential to the proper development of the law. An incorrect understanding is likely to hold back appropriate reforms, whether in one direction or another.

I am of the opinion that things have gone somewhat too far. However, I realize that it is reasonable to maintain that things have not gone far enough. Policy debates of this kind are entirely appropriate. But they should be open and honest, so that we can be clear about what we are doing and why. If it is difficult to maintain a narrative in which fiduciary duties are very weak, that would be strong evidence that the law is suboptimal. But if a new narrative can be developed and sustained, then perhaps we are on the right track after all. In fact, such a narrative might help corporate law theory and practice develop properly, rather than being held back by antiquated notions of the importance of loyalty. In any event, doing absolutely nothing about the diminishing duty of loyalty is not a valid option.