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ARTICLES

Normative Justifications for Lax (or No) Corporate Fiduciary Duties: A Tale of Problematic Principles, Imagined Facts and Inefficient Outcomes

*Rutheford B Campbell, Jr.*¹

INTRODUCTION

CORPORATE fiduciary duty standards are at an all-time low in this country. Ironically, the deterioration in standards has come to full maturity during the last two decades, a period of significant and notorious corporate managerial failures.

The deterioration in the standards by which we measure the appropriateness of the actions of corporate managers² has been fueled by influential judges³ and scholars⁴ (“Advocates”⁵), who vigorously—and seemingly quite effectively—argue in favor of a lax fiduciary duty regime for corporate managers.

Normative justifications for lax corporate fiduciary duty standards,

¹ James and Mary Lassiter Professor of Law, University of Kentucky College of Law. The author thanks David Anderson, Doug Branson, James Cox, Chris Frost, Frank Gevurtz, Doug Michael and Allan Vestal for their comments on earlier drafts of this paper.

² My term, “managers,” includes both officers and directors of the company. *See infra* notes 9 and 79 (discussing the extent to which officers and directors should be subject to the same fiduciary duties).

³ *See, e.g.*, William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 449–50 (2002) (justifying a lax standard of review as eliminating “liability risks that are disproportionate to the benefits of service” and as reducing judicial intrusiveness that “prolongs litigation without offsetting social utility”).

⁴ *See, e.g.*, Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965) (“[T]he market for corporate control gives . . . shareholders both power and protection commensurate with their interest in corporate affairs.”).

⁵ For convenience, I use the term “Advocates” for those who propose and support rules that result in lax fiduciary standards for corporate managers. I do not mean to imply that scholars who would support one particular rule necessarily support other rules. For example, in Part I of this Article, I discuss a rule that relaxes or eliminates managers’ duty of care, and in Part II, I discuss a rule that permits managers to facilitate unlimited wealth transfers that benefit non-shareholder constituencies at the expense of shareholders. Scholars who support the relaxation of fiduciary standards discussed in Part I may or may not support the relaxation in fiduciary standards discussed in Part II.

however, are weak. The justifications fail to provide a persuasive reason to abandon the economic principle more widely applied in society: to hold actors accountable for the full economic loss caused by their actions as a way to incentivize efficient conduct.⁶

The weaknesses in the Advocates' arguments have not escaped the attention of scholars, who have mustered convincing rebuttals to a significant portion of the Advocates' claims.⁷ Scholars have failed, however, adequately to address two of the arguments the Advocates offer in support of lax standards for corporate managers.⁸ These two arguments appear to be the most effective theoretical barriers to achieving efficient corporate fiduciary duty standards—standards that will create an incentive for efficient conduct on the part of corporate managers.

The first of the Advocates' inadequately challenged arguments is that corporate managers should not be held accountable for a lack of due care in their decisions. The Advocates justify this position by a claim that eliminating any duty of care provides an incentive for managers to take value-creating risks.⁹ The second argument of the Advocates¹⁰ is that managers should be free to allocate and re-allocate unlimited amounts of corporate wealth among various corporate stakeholders; the Advocates justify this position by a claim that such a rule provides an incentive for the investment of efficient levels of firm-specific capital by those who provide

6 While an award of damages for economic losses is common in society, such awards may often fall short of "full" economic losses. Tort recoveries are a good example. Tort defendants are typically liable for failure to prevent inefficient accidents, but the recoveries in such instances may be limited to amounts that are less than the plaintiffs' full economic loss. See, e.g., RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 192–98 (6th ed. 2003).

7 Two more recent articles are especially noteworthy in this regard. See Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 119–21 (2006) (arguing, *inter alia*, that market forces and social norms do not efficiently restrain mismanagement by corporate managers); Elizabeth A. Nowicki, *Director Inattention and Director Protection under Delaware General Corporation Law Section 102(B)(7): A Proposal for Legislative Reform*, 33 DEL. J. CORP. L. 695, 702–06 (2008) (discussing how behavioral psychology research demonstrates the effectiveness of negative reinforcement as a motivator). An example of an important earlier work is Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1420–27 (1985), which argues that competition for corporate managers and in the securities market fails adequately to limit managerial misconduct.

8 See discussion *infra* Parts I and II.

9 See, e.g., Allen et al., *supra* note 3, at 452 ("[I]f the risk of liability is disproportionate to the directors' incentives for service, directors may avoid making economically valuable decisions that might subject them to litigation risk." (citation omitted)); *id.* ("[A] rationality standard gives directors greater freedom to make risky decisions." (citation omitted)); see also Henry N. Butler & Larry E. Ribstein, *Opting out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 53–54 (1990) (noting that negligence liability "places a substantial business risk on managers who, unlike the shareholders, are unable to reduce the risk by diversification and are therefore relatively inefficient risk-bearers" (citations omitted)).

10 See *supra* note 5.

monetary and human capital to corporations.¹¹

The effect of freeing managers from any duty of care and removing limitations on their right to transfer wealth among corporate stakeholders, especially when considered together, is to reduce significantly the accountability of corporate managers for their actions. This, in turn, encourages managerial shirking, under-management, mismanagement, and expropriation of excessive amounts of corporate values or rents.

The broad purpose of this Article is to argue in favor of, and offer economic justifications for, a robust fiduciary standard for corporate managers. More specifically, I address the two unchallenged and seemingly effective arguments of the Advocates for allowing corporate managers to act without accountability for the full economic loss caused by their mismanagement. My intent is to show that the normative justifications offered by the Advocates in support of their arguments are founded on several essential factual assumptions that are unproven empirically, counterintuitive and, when unpacked and closely analyzed, seem highly improbable. In short, the factual assumptions offered in support of the Advocates' arguments amount to a thin reed and do not meet the burden that should be required of those who propose abandoning or broadly limiting corporate managerial accountability.

A strong version of corporate fiduciary duties promotes efficient and fair outcomes. Accountability on the part of corporate managers for their actions and decisions is integral to achieving these positive results. Without a regime that includes strong fiduciary duties and accountability for the full value of economic loss that results from managers' decisions, achieving efficiency and fairness is less likely.

I. NORMATIVE JUSTIFICATIONS FOR ELIMINATION OF THE DUTY OF CARE

The Advocates argue that corporate managers—directors, as opposed to officers, are usually the focus of their attention¹²—should be subject to

¹¹ See, e.g., Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1200–05 (2002).

¹² As will become apparent in this paper, the Advocates focus mostly on the matter of the fiduciary duties of directors. In light of the justifications the Advocates offer, however, their rules respecting fiduciary duties would seem equally applicable to officers and directors. See *infra* notes 27–28, 71–80 and accompanying textual discussion. Over the years, however, commentators have disagreed about the extent to which officers and directors are and should be subject to identical fiduciary duties. One aspect of this disagreement has involved the extent to which the business judgment rule is applicable to corporate officers. Compare Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 441 (2005) (application of the business judgment rule to officers' actions “is not firmly established in case law”), and *id.* at 440 (“the business judgment rule . . . should not be extended to corporate officers in the same broad manner in which it is applied to directors”), with Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor*

an extremely lax, or essentially no, duty of care. This position was well-captured by Chancellor Allen in *In re Caremark International Inc. Derivative Litigation*.¹³ The opinion states:

[A] director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good faith* effort to advance corporate interests.¹⁴

Chancellor Allen's articulation of the duty of care divides along a traditional business judgment analysis, separating the duty of care into process and decision and assigning different substantive standards to each of those two parts.¹⁵ With regard to process, which is usually thought of as the duty of the decision-maker to inform herself fully before making the decision, the obligation under Chancellor Allen's formulation is violated only if the decision-maker acted in bad faith.¹⁶ At the point of the actual

Johnson, 60 BUS. LAW. 865, 870 (2005) ("[T]here can be little dispute . . . that the application of the business judgment rule to officer action . . . is well established in the case law."), *and id.* ("[I]t is ordinarily appropriate to apply the business judgment rule to officers."). In Bernard S. Sharfman, *The Enduring Legacy of Smith v. Van Gorkom*, 33 DEL. J. CORP. L. 287, 296 n.53 (2008), the author finds "a strong argument that the decisions made by officers, where authority is granted through board delegation (non-board centralized authority), deserve just as much protection as decisions made by the board."

¹³ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

¹⁴ *Id.* at 967.

¹⁵ This approach—dividing the business judgment rule into the investigation stage and the decision-making stage—is consistent with the traditional approach taken, for example, in the PRINCIPLES OF CORPORATE GOVERNANCE. *See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c) (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE] (articulating the business judgment standard as requiring the director or officer at the process stage to be "informed . . . reasonably" and to make decisions "rationally" believing them to be "in the best interests of the corporation").

The significant deterioration in the standards respecting the duty of care is apparent when one compares the PRINCIPLES OF CORPORATE GOVERNANCE with *Caremark*. The *Principles* require the manager at the process stage to act reasonably while the *Caremark* language imposes only a good faith duty. At decision-making, the PRINCIPLES impose a "rationally" criterion, which may be equivalent to a gross negligence standard. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* § 4.01 cmt. f. *Caremark* imposes no standard at decision-making. *See In re Caremark*, 698 A.2d at 967.

¹⁶ PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 15, § 4.01 cmt. f. In recent years, Delaware has had a number of high profile cases dealing with the definition of good (or bad) faith. *See, e.g., In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 62 (Del. 2006) (defining bad faith as "'intentional dereliction of duty, a conscious disregard for one's responsibilities'" or "'[d]eliberate indifference and inaction in the face of a duty to act'" (quoting *In re Walt Disney*

making of the decision by the corporate manager, there is no applicable substantive duty. The decision-maker can thus “never” be held liable for a loss caused by a managerial decision, even, in the words of the court, if the decision is “stupid . . . egregious or irrational.”¹⁷

It is apparent that such an articulation essentially eliminates any duty of care on the part of corporate managers. So articulated, only process is subject to any standard, and that standard is so lax that only bad faith can violate the duty of process.

The idea that corporate managers should not be subject to a robust duty of care standard, and thus have no or limited financial accountability for harm caused by their actions, flies straight in the face of traditional economic analyses. Generally, economists assume that actors are rational and respond accordingly to both positive and negative stimuli.¹⁸ For example, saddling a defendant with liability for tort damages equal to the full economic loss of the plaintiff is seen to encourage efficient behavior on the part of the defendant. The analysis is founded on the notion that the negative stimulus generated by the threat of monetary liability provides an incentive for the defendant’s investment in efficient accident reduction. Similarly, in the areas of criminal law and criminal penalties, economists may analyze potential criminals as “rational calculators” who choose to commit crimes by weighing the positive stimuli (for example, the probability of getting money in a robbery) against the probability of negative stimuli (for example, the probability of getting caught and punished).¹⁹

This traditional economic approach is readily applicable to the area of corporate fiduciary duties and offers an economic basis for holding managers personally liable for breaches of their fiduciary duty of care. The negative stimulus generated by the risk of personal liability encourages managers to act with efficient levels of care. Conversely, the elimination of, or an extreme reduction in, the standard of care applicable to corporate managers reduces their incentive to act with efficient levels of care toward the end of maximizing the interests of the corporation or its owners. Without a standard of care, managers’ irresponsible actions generate consequences that no longer involve monetary penalties or judicial rebukes for the managers. This, accordingly, reduces the negative stimulus for managers to act in ways that further the best interests of the beneficiaries of the managers’ duties.²⁰

Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005)).

17 *In re Caremark*, 698 A.2d at 967 (internal quotation marks omitted).

18 See POSNER, *supra* note 6, at 17-21.

19 See, e.g., *id.* at 215-17.

20 Even those who argue in favor of a more lax standard of care generally recognize this point. See, e.g., Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 103 (2004) (“A complete theory of the firm thus requires that the law balance the virtues of discretion against the need to require that discretion be used responsibly.”)

Notwithstanding the apparent logic of this approach, Advocates have argued over the years that corporate managers should be free from any meaningful duty of care and financial accountability for harm caused by their mismanagement.²¹ For example, Advocates have claimed that the fiduciary duty of care is unnecessary, since economic forces in various markets and social norms provide corporate managers with adequate incentives for efficient conduct.²² Scholars, most recently Professors

(citation omitted)); Sharfman, *supra* note 12, at 307 (“fiduciary duties help to minimize irresponsible behavior and unnecessary error”). Two authors, however, suggest that “liability rules play a relatively minor role in assuring contractual performance by corporate managers in publicly-held corporations.” Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 263 (1986). A contrary view is offered by Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors’ Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 395 (2005) (“legal liability represents an essential mechanism for ensuring directors’ fidelity to their fiduciary duties”).

21 Professor Langevoort describes the arguments that have been offered to support a rejection of a rigorous standard of care, which include “overprecaution, refusals of good people to serve, demands for increased insurance, indemnification rights, and compensation for the residual risk.” Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 818 (2001) (citation omitted); *id.* at 826–28. Bernard Sharfman lists some of the “many good reasons” offered for a lax standard of care to include:

- (1) ensuring that directors are not held liable for honest mistakes of judgment; (2) encouraging individuals to become directors by protecting them from liability for decisions that turn out badly; (3) the desire, from a policy perspective, “[t]o avoid undesirable judicial intervention” in the affairs of a corporation; and (4) the concern that courts will find more negligence than really exists because of hindsight bias.

Sharfman, *supra* note 12, at 299 (alteration in original) (citations omitted). In Bainbridge, *supra* note 20, at 119, 122–23, the author offers another justification for a more relaxed standard of care. Professor Bainbridge argues that if required to interpret and enforce a rigorous standard of care, judges, who may lack skill and experience in such complex matters, may “shirk” and develop “heuristic problem-solving decision-making processes.” *Id.* at 119 (citations omitted). Thus, “rational shareholders will prefer the risk of director error to that of judicial error.” *Id.* at 122.

22 *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 4 (1991) (“dynamics of the market drive [corporate managers] to act as if they had investors’ interests at heart”); *id.* at 95–96 (discussing disciplinary impact of the market for corporate managers); Charles M. Elson & Robert B. Thompson, *Van Gorkom’s Legacy: The Limits of Judicially Enforced Constraints and the Promise of Proprietary Incentives*, 96 NW. U. L. REV. 579, 580–82 (2002) (discussing the arguments regarding discipline that may result from competition in “[m]arkets” (e.g., for products, capital, employment and control), “[c]ontracts and [o]ther [p]rivate [o]rdering,” “[l]aw” (e.g., securities laws), and various societal “[n]orms”); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 262–73 (1977) (discussing disciplinary impact generated by competition in various markets).

Elizabeth A. Nowicki²³ and Renee M. Jones,²⁴ have refuted these claims by demonstrating the highly problematic factual assumptions underlying the Advocates' arguments and the need for full accountability as an incentive for efficient management.²⁵

One argument in favor of eliminating the duty of care for corporate managers, however, remains inadequately challenged. It is currently the most fashionable and effective defense for the Advocates' position that corporate managers should owe their corporation and its shareholders no duty of care.

In this argument, the Advocates contend that a strict standard of care will lead to bad outcomes by inhibiting the managerial risk-taking that creates value for the corporation and its shareholders.²⁶ The idea is that managers who are fearful that a bad outcome from a corporate investment may result in their being sued personally by shareholders will, if subject to a strict duty of care, forego a risky corporate investment, even if the investment is profitable or value creating for the corporation and its shareholders.²⁷ Rational shareholders, therefore, will actually prefer a no duty of care regime, since it provides an incentive for the managers of their corporation to create value on their behalf.

23 See Nowicki, *supra* note 7, at 702–06 (discussing the work of behavioral psychologists, which supports the conclusion that negative reinforcement (personal liability) influences conduct of corporate managers).

24 Professor Jones recounts the long-standing claims that market forces and social norms provide corporate managers with sufficient incentives. She successfully demonstrates, through her use of prior scholarship and her own insights, a convincing refutation of those claims. Jones, *supra* note 7, at 118–21 (discussing discipline from market forces); *id.* at 121–44 (discussing the claim that social norms provide an incentive for corporate managers to engage in efficient conduct).

25 Earlier, powerful rebuttals of such claims were offered by notable commentators, such as Professor Victor Brudney. See Brudney, *supra* note 7, at 1420–27.

26 See, e.g., WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 254 (3d ed. 2009) (“Directors who risk liability for making unreasonable decisions . . . are likely to behave in a risk-averse manner that harms shareholders.”); R. Franklin Balotti & James J. Hanks, Jr., *Rejudging the Business Judgment Rule*, 48 BUS. LAW. 1337, 1342 (1993) (“motivating [directors] to be willing to take entrepreneurial risks” is a “persuasive” reason for a lax standard of care).

27 In *Joy v. North*, Judge Ralph Winter wrote:

Although the [business judgment] rule has suffered under academic criticism, it is not without rational basis.

...
 ... [B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions. . . . Shareholders can reduce the volatility of risk by diversifying their holdings. In the case of the diversified shareholder, the seemingly more risky alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others. . . .

This argument, however, does not stand up well to a critical analysis. The numerous essential factual assumptions necessary to support this justification for a no-standard-of-care regime are unproven and, when analyzed closely, seem highly improbable.

In considering whether any rule encourages directors to take value-creating risks, it is important, first, to appreciate the type of risk taking that benefits the corporation and its shareholders. This, in turn, requires an understanding of the basic economic concepts of volatility and expected value.

In economic terms, a volatile investment is one with a wide dispersion of outcomes, such as an investment with a 50% chance of achieving a value of \$100 and a 50% chance of achieving a value of \$0. The expected value of that investment is \$50, which amounts to $(.5 \times \$100) + (.5 \times \$0)$.²⁸

No one argues in favor of incentivizing managers to pay \$75 to accept that high risk investment opportunity. Obviously, because the expected value of that investment is only \$50, paying \$75 for the investment would not be in the best interests of the company or its shareholders. On the other hand, if the managers are offered that investment for \$25, it would seem to be in the best interests of the company and its shareholders for managers to purchase that investment.

Using the previous investment illustration to restate the position of those proposing an elimination of corporate managers' duty of care, the Advocates argue that managers operating under a rigorous standard of care are incentivized to reject that potentially profitable investment because of the high probability—50%—of a total loss.²⁹ The Advocates contend that in such circumstances, if there is a total loss—even though the decision to invest was consistent with the fiduciary duty to maximize the wealth of shareholders—shareholders will sue, claiming that the directors violated their duty of care.³⁰ Managers, therefore, fearing this, will eschew the profit

A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally.

Joy v. North, 692 F.2d 880, 885–86 (2d Cir. 1982) (citations omitted).

²⁸ The present value of the investment in this example may be discounted to a sum below 50 because of the volatility risk. See Rutheford B Campbell, Jr., *The Impact of Modern Finance Theory in Acquisition Cases*, 53 SYRACUSE L. REV. 1, 10–13 (2003) [hereinafter Campbell, *The Impact of Modern Finance Theory*] (discussing volatility risk, risk premiums and the calculation of risk premiums using the capital asset pricing model). Under popular economic theory, the extent of the discount depends in large part on the ability of investors to diversify their total investments. See *supra* note 27 regarding Judge Winter's discussion in *Joy v. North*. Although, economists generally recognize that diversification cannot eliminate "systematic" or "market" risk. See Campbell, *The Impact of Modern Finance Theory, supra*, at 10 (assuming, *arguendo*, that investors are fully diversified).

²⁹ See *supra* note 28 and accompanying textual discussion.

³⁰ See, e.g., Allen et al., *supra* note 3, at 450, 455–56; Bainbridge, *supra* note 20, at 110–15; Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 Wis. L. Rev. 573, 573–76;

maximizing conduct that would have been in the best interests of the company and its shareholders.³¹

This argument for elimination of the duty of care, however, is based on a number of unproven and highly questionable factual assumptions.

While the Advocates claim that a strict duty of care standard generates an incentive to reject value-maximizing investments in such high volatility situations,³² a strict standard also generates an incentive to accept such investments.

Consider once again the example of an investment opportunity that costs \$25 with a 0.5 probability of a \$100 value and a 0.5 probability of a \$0 value, and imagine that managers are operating under a negligence or reasonable person duty of care. The Advocates contend that managers will not make the investment because of the personal risk.³³ But, consider the risk managers take under such a strict standard if they unreasonably decide to reject the investment. An unreasonable failure to accept the investments means the managers have violated their negligence duty of care standard, which creates liability for them. This makes it difficult, at least for me, to conclude that managers operating in a strict regime and pursuing their self-interests in high volatility, positive value cases would likely elect to pass up the highly volatile, profitable investment.

In the case of such an investment opportunity, fully informed managers would be presented with the following options. Their first option would be to accept the investment, which is an action that is consistent with their fiduciary duties. Even though they act consistently with their fiduciary duties, there is a chance that they may be sued or that a court

Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 305–06 (1994) (discussing the Advocates' position generally).

³¹ It is possible to unpack these claims regarding directors' fears. First, one might assume that directors fear the mere filing of the lawsuit as well as the expense and reputational damage that occurs as a result. Just the filing would seem certain to generate negative utility to the average director. *But see* Gevurtz, *supra* note 30, at 310. Gevurtz suggests that the risk of litigation is overblown, relying on his observations that trial lawyers, who operate in a malpractice regime based on negligence, make countless qualitative decisions but that "challenges to trial decisions do not constitute the predominant source of legal malpractice claims" even though "trials inevitably produce losers, thereby providing a steady stream of prospective malpractice plaintiffs." (citation omitted). *Id.* At the next level, one might imagine that directors operating in a rigorous standard of care fear the enhanced likelihood of shareholders/plaintiffs ability to survive preliminary motions to dismiss, thereby generating significant settlement value. Finally, directors may fear that they ultimately—and improperly—will be held liable for a wealth enhancing decision that did not turn out well. Commentators typically rely on the hindsight bias to explain why directors operating under a strict standard of care are at risk for such an ultimate outcome. *See, e.g.*, Bainbridge, *supra* note 20, at 114 ("[T]here is a substantial risk that suing shareholders and reviewing judges will be unable to distinguish between competent and negligent management because bad outcomes often will be regarded, *ex post*, as having been foreseeable and, therefore, preventable *ex ante*." (citation omitted)).

³² *See supra* notes 28 and 30 and accompanying textual discussions.

³³ *See supra* notes 28 and 30 and accompanying textual discussions.

may, albeit wrongly, conclude that their decision was negligent and hold them personally liable for a breach of fiduciary duty. The managers' other option when operating under a strict standard of care and presented with a high volatility, positive value investment is to reject the investment, which will amount to a breach of their fiduciary duty. If they are sued as a result of rejecting the investment and a court reaches a proper decision, the managers will be found to have violated their duty of care and will be held personally liable.

While certainly this is a polemic about the facts, if I were a manager pursuing only my own self-interests in such a case, I am certain what I would do: I would accept the value-creating investment and run the risk of a groundless suit and a wrong outcome. I would conclude that on balance I would be less likely to face personal disutility if I were to follow the law.³⁴ My view of the facts, therefore, suggests that on balance, a strict standard is likely to move managers to act in a way that creates value in such high volatility cases.³⁵

Now consider the other example—an offer to purchase for \$75 a highly volatile investment with an expected value of \$50. Managers operating under a negligence regime have, once again, a strong incentive to make the value-maximizing decision, which obviously is to reject the investment. If managers unreasonably accept the investment, they violate the standard of

34 I would, of course, attempt to limit my exposure by a decision-making apparatus that would enhance the probability that I could demonstrate my due diligence, which, of course, enhances the probability of a sound decision.

35 In such a case, one may argue that directors operating under a strict standard of care have an incentive to reject the high volatility, positive value offers in order to avoid the risk of liability based on an unfounded suit, and then to conceal their decision in order to avoid the risk of liability from a well-founded suit. Again, this scenario seems problematic. First, it is not at all clear how often directors face positive value transactions with volatility so high that it would influence their actions. See *infra* notes 38–42 and accompanying textual discussion. If such cases are rare, there is not an economic incentive for directors to establish the system necessary to conceal their breaches of their fiduciary duties. Second, establishing a system to implement the strategy would be expensive for directors as well as for others who may face professional and legal liability for their participation. Considering directors, the question is the extent to which directors would be willing to participate in a system of corporate governance that subverts both value-creating decisions that they are obligated to make and the requirement that they act on a fully informed basis. A below-the-radar-screen process to deal with high volatility, positive value cases would seem to involve the directors in a dangerous situation. It seems quite likely, for example, that any lawsuit alleging a breach of fiduciary duty would uncover the system. It also would involve directors in a situation that, at least one must hope, is morally distasteful to them. Deploying such a system would seem likely also to involve the assistance of legal counsel, which will raise a significant professional issue for the corporation's lawyer. Lawyers' professional, ethical standards oblige them to act in the best interests of their client, which is the corporation, and not its officers or directors. See Rutheford B Campbell, Jr. & Eugene R. Gaetke, *The Ethical Obligation of Transactional Lawyers to Act as Gatekeepers*, 56 RUTGERS L. REV. 9, 17 (2003) (“[A] lawyer representing a corporation . . . represents the corporate entity itself and does not . . . represent any of the constituents of the corporation such as the directors [or] officers . . .” (citations omitted)).

care and are liable. With no duty of care obligation, however, the personal liability incentive of corporate managers to do the right thing—to reject the investment—is lost. Managers could accept the investment without risk of any liability.³⁶ Once again, the strict standard of care provides the better incentive for efficiency.³⁷

The notion, therefore, that a rigorous standard of care, such as negligence, provides an incentive to engage in conduct that is contrary to the best interests of the corporation and shareholders seems highly problematic.

An even more obvious failure of the Advocates' argument in favor of a no-or-extremely-lax standard of care, however, is in the apparent but unarticulated factual assumption regarding the prevalence of managerial decisions involving high risk, positive value matters. While essentially all management decisions involve *some* volatility in outcome,³⁸ the negative impact upon which the Advocates base their argument occurs only in those decisions where the volatility is *so high* that managers are inclined to reject value creating investments.

For the argument of the Advocates in favor of a no-or-extremely-lax duty of care regime to be persuasive, corporate managers in a significant number of their decisions must face situations involving a positive expected value with volatility so high that they will fail to take the right path for fear of personal liability. Such cases must be sufficiently prevalent so that the total, overall gains from eliminating managers' inefficient, non-value maximizing decisions in such high volatility cases outweigh the increased agency costs generated by an elimination of or extreme reduction in the standard of care.

Not only are such decisions not prevalent, they, indeed, seem to occur quite infrequently. Relying on my own experiences as a law professor, a transactional lawyer providing counsel to corporations, and a member of boards of directors for profit and not-for-profit corporations, I am hard pressed to think of an instance growing out of these experiences in which a profitable investment or decision was so volatile that fear of liability

36 Under the rational assumption that the time required to make a careful decision is greater than the time required to make a casual decision, a no-liability regime incentivizes the decision maker (corporate manager, in our case) to make a poorly considered decision. With no liability for a poorly made decision, the incentive of the corporate manager is to reduce his opportunity costs (loss of leisure time, for example) by devoting less time to considering and analyzing the decision.

37 This is another example of the point developed earlier in this paper. *See supra* notes 28–34 and accompanying textual discussion. The gains envisioned by the Advocates are limited to cases in which volatility is so high that managers will not make the value maximizing decision. The reduced duty of care standard, however, applies to all decisions made by corporate managers. This makes it difficult to conclude that their regime generates *net* efficiency gains.

38 *See* Campbell, *The Impact of Modern Finance Theory*, *supra* note 28, at 10–11 (describing the impact of “risk” on present value).

impacted a board's action. While certainly this sometimes occurs,³⁹ my own experiences suggest strongly that the vast majority of decisions by managers are made on the basis of expected value, not volatility.

Consider, in that regard, the types of decisions that particular managers make. Directors, for example, make decisions regarding hiring of senior officers, compensation for senior officers, granting stock options for senior management, approving major investments (in technology, capital assets, real estate, etc.), approving acquisitions, and selling major assets or divisions. These types of decisions seem overwhelmingly to be the types of decisions that managers make on the basis of expected value and infrequently to involve circumstances in which the best deal for the company involves such high volatility risk that directors would be inclined to make a non-value maximizing decision.

The prevalence of decisions involving valuable but highly volatile investments is obviously important in measuring the net gain (or loss) generated by an abandonment of a rigorous duty of care obligation. The Advocates propose an across the board reduction in the standard of care, which means that *every* decision of managers would operate without the negative incentive provided by a rigorous standard of care and liability for a violation of that standard of care. The gains they envision, however, will be generated—at least if my factual reckoning is correct—in very few instances. This makes it even more difficult to imagine facts that support the position of the Advocates.

The Advocates, therefore, are unpersuasive regarding two factual assumptions, both of which are essential to support their argument in favor of a no-or-lax duty of care regime. First, in high volatility cases, it seems likely that a strict duty of care provides more incentive to make value creating decisions than does a no-or-limited duty of care. Second, there are very few cases where the volatility risk is so high that it would cause managers operating under a strict duty of care to make the wrong decision.

Concluding that the Advocates are wrong in their factual assumptions destroys their normative justification for a no duty of care regime. Their failure in that regard, however, does not by itself determine the appropriate level of care for corporate managers. The question remains: What is an

³⁹ Of course, it can happen that a positive value investment opportunity involving a highly volatile outcome could cause managers to eschew the investment. In an acquisition setting, for example, a corporation may be offered a take it or leave it deal at \$100, and the company's financial advisers may tell the board that if they loose that offer, there is a 50% chance of a deal at \$60 and 50% chance of a deal at \$160. In that high volatility situation, a board may be inclined to take the \$100 offer in lieu of shopping for a better deal with a higher expected value. My factual polemic with the Advocates is based on my opinion that these situations occur infrequently, and certainly not with sufficient prevalence to generate the gains necessary to offset the losses caused by applying a no-or-extremely-lax standard of care to all management decisions.

efficient level of care to impose on corporate managers?

The starting point in deciding what, if any, standard of care leads to pleasing outcomes is the familiar economic notion that in the absence of negative externalities parties should be permitted to fashion their own arrangements.⁴⁰ The logical extension of that notion, which once again is familiar, is that society, in formulating its rules, generally is able to promote efficiency and fair outcomes through rules that approximate the arrangements that parties would make in most cases.⁴¹ Applying this analysis, an efficient standard of care is the standard that corporate owners and managers would agree on in most cases.

While it certainly is a daunting task—more likely, an impossible task—to provide a definitive answer to the question of what standard of care is efficient, some scholars—much to their credit—have attempted to generate empirical evidence on this matter. These scholars have examined the circumstances surrounding the adoption by states and corporations of provisions that limit directors' monetary liability. The statutes, which have been widely adopted by states⁴² and widely approved and implemented by corporations,⁴³ permit a corporation in its articles of incorporation to limit directors' monetary liability to the corporation to actions "not in good faith" or involving "intentional misconduct."⁴⁴ Because shareholders are required to vote on these amendments to the company's articles of incorporation, some scholars suggest that the approval of these provisions by corporate shareholders should be seen as an expression by shareholders of a

40 See, e.g., POSNER, *supra* note 6, at 71; Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487 (1980) (offering a moral defense for the pursuit of economic efficiency based on the consent of the parties).

41 Ruthford B Campbell, Jr., *Bumping Along the Bottom: Abandoned Principles and Failed Fiduciary Standards in Uniform Partnership and LLC Statutes*, 96 KY. L.J. 163, 170 (2008) [hereinafter Campbell, *Bumping Along the Bottom*] ("Even where the transaction will occur, a societal rule that mimics the arrangement that most of the parties would select in most cases may promote efficiency by eliminating the need of the parties to bargain and thereby reduce transaction costs. The next principle, therefore, is that in instances where constructing their own terms is inefficient or impossible for parties, society ought to enact broadly applicable rules consistent with those that the parties in most circumstances would select, if they were able to bargain." (citation omitted)).

42 Overwhelmingly, states have adopted these limited liability statutes. See Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160 (1990) [hereinafter Romano, *Corporate Governance*] ("Within two years [of Delaware's adoption of a limited liability statute], forty-one states . . . amended their corporation statutes to reduce directors' liability . . .").

43 Companies widely have amended their articles of incorporation to adopt the limited liability provisions for directors. See Lawrence A. Hamermesh, *Why I do not Teach Van Gorkom*, 34 GA. L. REV. 477, 490 (2000) (reporting 98 out of 100 from a sample of Fortune 500 companies had such provisions).

44 See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (West, Westlaw through 2010) (limiting directors' liability for monetary damages to "acts . . . not in good faith or which involve intentional misconduct or a knowing violation of law . . .").

preference for a very low standard of care.⁴⁵ Predictably and convincingly, however, other scholars discount the significance of these actions, citing “management domination of the approval process and the severe problems of collective action confronted by shareholders.”⁴⁶

Professor Roberta Romano, pursuing a more sophisticated empirical path, used “conventional financial econometric techniques” to examine the stock market’s reaction to the adoption of these limited liability provisions.⁴⁷ She looked at the stock market’s reaction when Delaware adopted its limited liability statute and again when particular firms adopted limited liability amendments to their articles of incorporation.⁴⁸ Her idea was that, “[i]f investors believe that directors are deterred by the duty of care (that liability for negligence has a positive effect on stockholders’ wealth), then a firm’s shares will experience significant negative abnormal returns when the market learns of plans to adopt a limited liability provision.”⁴⁹

While Professor Romano found some evidence of “significantly negative cumulative abnormal returns”⁵⁰ (CARs) in studies looking at the impact of the limited liability provisions on companies’ stock prices, based on her own work and that of others, as well as considering the data as a whole, she concluded that “the event study data provide[d] no convincing support for a perceived deterrent effect from directors’ liability for negligence.”⁵¹

45 See Sharfman, *supra* note 12, at 289 (Delaware statute limiting director liability gave “shareholders . . . the opportunity to veto the *Van Gorkom* decision if they found it was not in their best interests. And veto they did.”).

46 J. Robert Brown, Jr. & Sandeep Gopalan, *Opting Only In: Contractarians, Waiver of Liability Provisions, and the Race to the Bottom*, 42 IND. L. REV. 285, 287 (2009) (citation omitted). Brown and Gopalan also make a powerful point that, in light of the fact that amendments to articles of incorporation must first be approved by the board of directors, “once management obtains adoption, the provision remains in place, irrespective of the wishes of shareholders, until management decides to initiate a change.” *Id.*

47 Romano, *Corporate Governance*, *supra* note 42, at 1183.

48 *Id.* at 1160–61.

49 *Id.* at 1183.

50 *Id.* at 1187.

51 *Id.* at 1187–88. Professor Romano first looked at the impact on a company’s stock price when the company adopted a limited liability amendment. While she reported one study that found “significantly negative cumulative abnormal return[.]” (CAR) in connection with firms’ adoption of a limited liability provision, based on her own studies and those of others, she concluded that “[t]he data . . . do not provide support for such deterrent effect [of duty of care lawsuits].” *Id.* at 1183. She dismissed the contrary study as “[a]n arbitrarily chosen significant statistic amidst a mass of insignificant ones . . .” *Id.* at 1184. Again, using econometric techniques, she also looked at the impact of the adoption of Delaware of its limited liability statute on a portfolio of seventy Delaware firms. In these data, she found abnormal negative returns, some of which were statistically significant. These data she characterized as “the only evidence that supports a general deterrent role for duty of care lawsuits.” *Id.* at 1186. Considering the data as a whole, she concluded that “the event study data provide no convincing support for a perceived deterrent effect from directors’ liability for negligence.” *Id.* at 1187–88.

Some may consider Professor Romano's data a bit more ambiguous. In all events, however, there are reasons—other than a shareholder preference for a lax standard of care—that might explain why the adoption of limited liability provisions may not generate negative cumulative abnormal returns in stock prices.

The most obvious reason is that investors may view limiting directors' monetary liability to only highly culpable acts as changing almost nothing. The starting point—the standard of care imposed on directors before the enactment and adoption of the limited liability provisions—may be viewed by investors as so low that the new limited liability standard changed very little.⁵² For example, in *Caremark*, the Delaware Chancery Court stated that the duty of care involved only the obligation to engage in a process that met a good faith standard.⁵³ This is essentially the same standard of care adopted in the limited liability statutes.⁵⁴ If the market viewed the *Caremark* standard as applicable immediately, before the adoption of the statute, the statute and its adoption by corporations amounted to no change in the standard of care.

In short, there is little empirical data supporting the notion that an extremely lax standard of care is an efficient, value-creating regime that would be preferred by corporate shareholders. In identifying an efficient standard of care, therefore, we are relegated to logic and analysis informed by common experiences. This approach suggests that a robust duty of care amounts to an efficient fiduciary standard, the standard that the parties would agree upon in most cases if they were fully informed, able to bargain with one another, and able to exercise market options. In such circumstances, it seems unlikely that investors and managers in most cases would agree on fiduciary duties that are paltry, anemic, or, in the most extreme case, nonexistent.

My conclusion on this matter is based on the following assumptions and analyses.

It seems axiomatic that when investors provide capital and assume a passive role in the management of that capital, their strong preference is for sound and reasonable management and accountability. A strong version

⁵² Professor Romano's data may offer some support for the theory that Delaware's standard of care was so low that the limited liability statutes changed nothing. Her research in the late 1980s suggests, for example, that previously decided duty of care cases brought as derivative suits usually did not result in significant recovery or settlement in favor of the company. *See id.* at 1168 (“[Duty of care] suits rarely result in a financial recovery The only monetary recovery in the vast majority of settled duty of care suits is plaintiffs' attorneys' fees”). These data may be consistent with a very low, legally enforced standard of care.

⁵³ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967–68 (Del. Ch. 1996); *see supra* notes 13–17 and accompanying textual discussion.

⁵⁴ *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West, Westlaw through 2010) (Limiting directors' liability for monetary damages to “acts . . . not in good faith or which involve intentional misconduct or a knowing violation of law.”).

of corporate fiduciary duties provides the incentive for good management, and thus in that regard is attractive to investors.

The fact, however, that investors have a preference for sound management does not establish the efficiency of a strict duty of care standard. One must consider the cost to investors of acquiring such a heightened standard of care. Although investors may *prefer* a strict standard of care, they may be unwilling to pay the costs of such a high standard.⁵⁵ To use a quantified example, corporate managers may be willing to provide their services to corporate owners (investors) under a no-or-extremely-lax duty of care standard for \$10, but the managers would demand \$20 to operate under a negligence standard.⁵⁶ In such a situation, although investors may prefer a negligence standard over a lax standard of care, investors may be unwilling to pay the extra \$10 for their preferred standard, and thus the parties, if able to bargain, would settle on the no-or-extremely-low duty of care.

Continuing with this quantified example, the power of corporate managers to extract additional compensation for their liability under a negligence standard depends on competition in the management market.⁵⁷ Considering, for example, the market for directors, to the extent there is a deep supply of capable directors, competition in that market would limit the power of directors to extract monopolistic returns for their services under the more rigorous duty of care standard.

It is on this matter that my view of the facts may be remarkably different from the view of those who argue for lax fiduciary duties. The factual assumptions indulged by those arguing in favor of lax fiduciary duties include the assumption that a strict duty of care will make it difficult or impossible to find competent managers for corporations.⁵⁸ Available data may suggest, however, that there is a deep supply of capable corporate managers, especially corporate directors.

In today's world, directors of public companies are very well paid. The annual median compensation for basic board service for the top 100 companies listed on Nasdaq and on the New York Stock Exchange is in excess of \$200,000.⁵⁹ Data suggests that boards meet eight to ten times per

55 See Campbell, *Bumping Along the Bottom*, *supra* note 41, at 182.

56 This is often stated in terms of the difficulty of finding competent directors, if they are subject to large liabilities as a result of a breach of their duty of care. Professor Gevurtz argues that this is no different from doctors and other professionals. "In fact, a comparison of actual awards against negligent directors versus other professionals might suggest directors have little to complain about." Gevurtz, *supra* note 30, at 313 (citation omitted). While one may argue that the relative liability risks described by Professor Gevurtz have changed since his article appeared in 1994, director compensation has also changed. See *infra* notes 59 and 60, regarding directors' compensation.

57 See Manne, *supra* note 4, at 110, 117-18.

58 See *supra* note 21 and accompanying textual discussion.

59 FREDERIC W. COOK & CO., INC., 2010 DIRECTOR COMPENSATION: NASDAQ 100 VS.

year.⁶⁰

Based on *self-reported* information, directors estimate that they spend an average of sixteen hours per month on board business matters, which includes total time spent on “review and preparation . . . , meeting attendance and travel.”⁶¹

Directorships are very attractive jobs. In addition to the extremely generous monetary compensation, there are significant non-monetary benefits in the form of networking, relationship building, and associations that open doors and advance one’s business and personal goals. Not surprisingly, data suggest that directors are generally very satisfied with their directorships.⁶² Korn/Ferry reports that eighty-six percent of directors in its 2007 survey are “extremely satisfied” or “very satisfied” as a director.⁶³ Also, forty-six percent of the directors in its survey say their satisfaction has

NYSE 100: NON-EMPLOYEE DIRECTOR COMPENSATION AT THE 100 LARGEST NASDAQ AND 100 LARGEST NEW YORK STOCK EXCHANGE COMPANIES 7 (2010), http://www.fwcook.com/alert_letters/2010_Director_Compensation_NASDAQ_100_vs_NYSE_100_Non-Employee_Director_Compensation_at_the_100_Largest_NASDAQ_and_100_Largest_New_York_Stock_Exchange_Companies.pdf. The 2010 median directors’ compensation for basic board service (not including additional compensation for committee service) was \$235,000 for the 100 largest Nasdaq companies and \$225,000 for the 100 largest New York Stock Exchange companies. *Id.*

60 *Id.* at 5. The foregoing report assumed eight board meetings and five committee meetings per year. In 2006, General Electric directors had ten board meetings, plus committee meetings, and the average compensation for General Electric’s non-management board members that year was approximately \$437,357. Gen. Elec. Co., Proxy Statements (Schedule 14A) (Feb. 28, 2007), *available at* <http://www.sec.gov/Archives/edgar/data/40545/00011931250704510/ddef14a.htm>. That same year, Halliburton’s directors had nine board meetings, plus committee meetings, and received average compensation of approximately \$310,257. Halliburton Corp., Proxy Statement (Schedule 14A) (Apr. 2, 2007), *available at* <http://www.sec.gov/Archives/edgar/data/45012/000095012907001807/h44591ddef14a.htm>. In 2006, one prominent board member of General Electric, Sam Nunn, former United States Senator from Georgia, received compensation for his board and committee service of \$536,233. Mr. Nunn reported that he also served on the boards of Chevron, Coca-Cola, and Dell. He reported that he was at the same time “co-chairman and CEO of the Nuclear Threat Initiative and the chairman of the board of the Center for Strategic and International Studies . . . [and] distinguished professor at the Sam Nunn School of International Affairs at Georgia Tech.” GEN. ELEC. CO., SCHEDULE 14A, *supra*.

61 KORN/FERRY INT’L, 34TH ANNUAL BOARD OF DIRECTORS STUDY 27 (2008), *available at* <http://www.kornferry.com/Publication/9955>. A study by Korn/Ferry found that in 2007 directors of North American corporations reported an average of sixteen hours per month spent on board matters. In evaluating this, it is important to realize that this was self-reported by the director and included “review and preparation time, meeting attendance and travel.” *Id.* Professor Eisenberg published various data from a 2004 study respecting director service. He concluded: “[c]ounting in committee time . . . the average number of hours a year spent by the directors on corporate affairs . . . [is] around 100.” MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 198 (9th ed. 2005)(citing MERCER HUMAN RESOURCE CONSULTING, TRENDS IN OUTSIDE DIRECTOR COMPENSATION 18 (2004)).

62 KORN/FERRY INT’L, *supra* note 61, at 8 (internal quotation marks omitted).

63 *Id.*

“improved” since five years ago.⁶⁴

All of this supports the view that director positions are appealing, and therefore, it is likely that there is a deep supply of highly capable people willing to serve as directors for the generous monetary compensation (and other benefits) received by today’s directors for one to two hundred hours of (self-reported) work per year. When I think about the capable people I know in my own life—academics, lawyers, bankers, business people, etc.—I find a deep supply of potential directors. It is this supply that may make it difficult for managers to exact a significantly higher price for their services if they were held to a strict standard of care.

Certainly I understand—indeed, I emphasize—that once again the polemic is about facts, and my view of the facts may not be shared by some. But, consider the factual assumptions necessary to support a low or non-existent fiduciary duty of care. One would have to assume that in most cases fully informed corporate owners (investors or shareholders) who are able to bargain and exercise market options would turn over their capital to managers who operate with few or no fiduciary duties and little legal or financial accountability for mismanagement. The assumptions are that corporate owners would do this because managers would be able to exact rents so high that owners would prefer the lack of accountability over the price of the higher standards. Such factual assumptions, once again, seem problematic.⁶⁵

64 *Id.* at 26.

65 My assumption that the corporation or shareholders are able to bargain with directors may be considered a weakness in my reckoning on this matter. In any “bargaining” between the corporation (shareholders) and directors over the pricing of a strict duty of care, the board of directors itself would to a large extent act on behalf of the corporation (shareholders). This is a result of the fact that directors set their own salaries, *see* MODEL BUS. CORP. ACT § 8.11 (2006), and are able to exert significant control over board nominees and composition. *See id.* § 8.01(b). Thus, even though there is a deep supply of potential directors ready to serve in the event that incumbent directors overprice a strict duty of care, the discipline of such competition may be diminished, because the board sets its own salaries and has influence over board composition. An argument may be made, therefore, that the board, in response to a strict standard of care, may price its services so high that shareholders would be unwilling to pay the extra expense. There are factors, however, that ameliorate the boards’ incentives to overprice its services. First, shareholders elect directors and thus could refuse to elect directors who overprice their services. Relevant here are the federal proxy rules, which require extensive disclosures of directors’ compensation. *See* 17 C.F.R. § 229.402(k) (2010) and the recently adopted proxy access rules, which require a company in some instances to include shareholders’ board nominees in the company’s proxy materials, 17 C.F.R. § 240.14a-11 (2009). Second, because setting their own salary involves directors in a conflict, directors’ salary decisions should be subject to the strict fiduciary duty standards under the intrinsic fairness test. Third, the “say on pay” movement with regard to officer compensation, driven as it is by Rule 14a-8 proposals, 17 C.F.R. § 240.14a-8 (2010), may dissuade directors from using a strict duty of care standard as a basis for paying themselves extremely high salaries. Perhaps even more to the point, it would seem perverse to justify a lax standard of care based on directors’ threats of using their strategic power to extract rents.

In summary, the Advocates' arguments in favor of the elimination or extreme reduction of the duty of care for corporate managers are unpersuasive. Their facially problematic factual assumption, which is that managers on the whole will act in more efficient ways if they are subject to essentially no duty of care and thus no liability or accountability, does not stand up well to close scrutiny. Instead, the more reasonable factual assumptions support a negligence or reasonable person standard of care as more likely to promote efficiency. Traditional economic thought assumes that persons respond both to positive and negative stimuli. Holding managers liable for harmful, unreasonable decisions provides appropriate stimuli for efficient conduct.

II. NORMATIVE JUSTIFICATIONS FOR MANAGERS' RIGHTS TO MAKE UNLIMITED WEALTH TRANSFERS

The Advocates⁶⁶ argue that directors⁶⁷ should be permitted to facilitate transactions that transfer virtually any amount of wealth from one corporate constituency (or stakeholder) to any other corporate constituency.⁶⁸ The

66 The most influential scholarly articulation of this position is Blair & Stout, *supra* note 11.

67 Professors Blair and Stout, for example, focus their discussion on directors. Blair & Stout, *supra* note 11. Their arguments support the application of their rule to decisions by corporate officers as well as directors. *See infra* note 73 and accompanying textual discussion.

68 The Advocates also argue that, as a positive matter, the law in its present state permits directors to engage in transactions that involve the transfer of virtually any amount of corporate wealth among corporate constituencies. For example, in Stout, *supra* note 11, at 1202 (citation omitted), the author opines that the “revealed preferences” of Delaware judges “give[] directors free rein to pursue strategies that reduce shareholder wealth while benefiting other constituencies.” Professors Blair and Stout describe directors’ authority to make wealth transfers among corporate constituencies as “virtually absolute,” Blair & Stout, *supra* note 11, at 251, and as involving “tremendous discretion to sacrifice shareholders’ interests in favor of management, employees, and creditors,” and as involving “ultimate decision-making [and] full discretion.” *Id.* at 291–92. Professors Blair and Stout do, however, recognize two limits on directors’ authority to facilitate wealth transfers among corporate constituencies. First, directors are subject to duty of loyalty requirements, which, for example, prohibit their transferring wealth from other constituencies to themselves by stealing. Nevertheless, Professors Blair and Stout view the directors’ duty of loyalty as applicable “to only a very limited subset of all the possible situations” involving deep conflicts of interest. *Id.* at 299. Second, directors, they believe, are subject to the duty to take actions that benefit the “corporation” as a whole, which seems to mean the interests of all privileged constituencies as a whole. *See id.* at 289 (directors’ “fiduciary obligations . . . run to the firm as a whole”); *see also id.* at 300 (stating that there is liability under the business judgment rule “only . . . where a finding of liability serves the collective interests of all the firm’s members” (citation omitted)). The positive claim of the Advocates—that directors’ fiduciary duty permits unlimited wealth transfers that benefit non-shareholder constituencies at the expense of shareholders—is disputed by other scholars. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 468 (2001) (“The triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured . . . [That model has established] duties to serve the

most contentious application of this rule would empower directors to take actions that transfer virtually unlimited wealth from shareholders to non-shareholder constituencies, such as creditors or employees.

The reasoning that the Advocates offer in support of their normative conclusion starts with the factual assumption that high transaction costs make it impossible for the various corporate constituencies to draft complete contracts with the other constituencies.⁶⁹ As a result, the Advocates posit, non-shareholder constituencies are unable by means of contract to protect themselves from rent seeking or expropriative actions by other constituencies—most likely shareholders.⁷⁰ Under the traditional approach that obligates directors to maximize shareholder wealth, directors have an incentive to facilitate the expropriation of wealth from the unprotected, non-shareholder constituencies for the benefit of shareholders.⁷¹ Seeing this risk of losing the value of their investment, the Advocates believe that non-shareholder constituencies are unwilling to make efficient levels of firm-specific capital investment.⁷²

Unpacking this line of argument through examples, perhaps workers would not make firm-specific human capital investments in training,⁷³ perhaps creditors would not loan money to corporations,⁷⁴ and perhaps

interests of shareholders alone . . . [T]he standard model of shareholder primacy has always been the dominant legal model in . . . the U.S.”); see also Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021, 2031 (1993) (recognizing that U.S. corporation law seeks to “maximize shareholder wealth”).

69 Blair & Stout, *supra* note 11, at 264 (“[T]ransaction costs and other market imperfections often make it impossible to achieve the required coordination through impersonal individual exchanges in markets or even through a set of explicit contracts.” (citation omitted)).

70 *Id.* at 249-50 (“Yet trying to prevent shirking and rent-seeking by defining individual team members’ duties and rewards through explicit contracts can be impossibly difficult . . .”).

71 A regime that obligates directors to maximize shareholder wealth may in some cases obligate directors to engage in transactions that do not maximize the total value of all corporate constituencies. This is because a transaction that is neutral with regard to the value of the whole or, indeed, even reduces the value of the whole, can increase shareholder wealth by expropriating value from non-shareholder constituencies. See Rutheford B Campbell, Jr., *A Positive Analysis of the Common Law of Corporate Fiduciary Duties*, 84 KY. L.J. 455, 460-69 (1996).

72 Blair and Stout, *supra* note 11, at 292. If a corporate board is controlled by any of the “corporation’s constituencies, that constituency could use its power over the board to seek rents opportunistically from other members of the productive team, thus discouraging team-specific investments.” *Id.*

73 Blair and Stout give the following example: “The marketing specialist, for example, must develop specialized knowledge and personal contacts (firm-specific human capital) whose value is vulnerable to actions and decisions of the team as a whole—likewise for the technical specialist.” *Id.* at 276.

74 See *id.* (“[W]hile the cash contributions of financial investors may initially be generic and fungible, once those funds have been used to purchase specialized assets or to pay wages, they effectively become sunk in the firm.” (citation omitted)).

communities or states would be reluctant to invest in industrial parks or grant tax breaks as a way of attracting companies to locate in their areas. Recognizing their firm-specific capital investments are at risk of expropriation by boards that are required to act in the best interests of shareholders, those non-shareholder constituencies—workers, creditors, and communities, in my examples—would consciously decide not to invest their capital up to an efficient level.

The Advocates' prescription for these problems is to unhook directors from any legal obligation to act in the best interests of shareholders and, instead, to allow directors freely to make decisions that redistribute corporate wealth among the various constituencies.⁷⁵ Freeing directors in this way, they believe, will enable directors to make value-enhancing decisions that will maximize the total value of all the privileged constituencies⁷⁶ and thus lead to efficient outcomes.⁷⁷ Directors, the Advocates believe, are incentivized to make efficient, value maximizing decisions because of their right to a reward—apparently directors' fees—consisting of “a nominal share of the team's output.”⁷⁸ Seeing that directors are freed of any legal obligation or incentive to engage in rent seeking on behalf of shareholders, “team members”—most importantly, non-shareholder constituencies—“feel they can . . . safely invest” and thus will make efficient investments in firm-specific capital that the Advocates believe non-shareholder constituencies would be afraid to make under a traditional regime.⁷⁹

⁷⁵ See *id.* at 254 (finding that their approach “suggests that directors should not be under direct control of either shareholders or other stakeholders”).

⁷⁶ Blair and Stout seem to define the privileged constituencies—those constituencies whose “joint welfare function[s]” should be maximized by a corporate board—as “individuals who make firm-specific investments” in the company. *Id.* at 288. “For most public corporations, these are primarily executives, rank-and-file employees, and equity investors, but in particular cases . . . may also include other stakeholders such as creditors, or even the local community if the firm has strong geographic ties.” *Id.*

⁷⁷ *Id.* at 274 (concluding that the total value can be enhanced if shareholders give up control “over the team's assets, as well as the right to allocate output among team members”).

⁷⁸ *Id.* The authors point out:

Directors are compensated, often quite handsomely, for their services to the coalition. This gives them an incentive to try to maintain their positions by satisfying the minimum demands of all of the important corporate constituencies, lest some critical constituents withdraw and the coalition fall apart. (After all, if the team falls apart, the directors lose their jobs.)

Id. at 283 (citation omitted). The authors state that this incentive does not, however, amount to a “tight constraint.” *Id.* But they also find supplemental incentives for the directors to “maximize the joint welfare function of all the firm's members” from the “duty of loyalty,” “severely limiting their abilities to serve their own [interests]” and the “cultural norms of fairness and trust.” *Id.* at 315–16.

⁷⁹ *Id.* at 274. This textual discussion demonstrates that the Advocates' rule must apply to the fiduciary obligations of corporate officers as well as directors. See *supra* note 67 and

As is apparent from this discussion, the net efficiency gains that the Advocates see as generated by their regime depend on a number of factual assumptions. Although the Advocates are careful not to claim any definitive empirical evidence in support of their factual assumptions,⁸⁰ it is helpful here to explicate their essential factual underpinnings and to illuminate the disagreement that one might find concerning their assumed facts.

Consider the factual assumptions necessary for the gains that the Advocates see in their regime. Three of their assumptions can be grouped together: (1) that transaction costs prevent non-shareholder constituencies from protecting their firm-specific investments by contract; (2) that non-shareholder constituencies will recognize their vulnerability to inappropriate sharing of rents and expropriation of their firm-specific investments; and (3) that, recognizing this risk, the non-shareholder constituencies will respond by choosing not to make efficient levels of firm-specific investments.

These assumptions of the Advocates may be illuminated by focusing on the following non-shareholder constituencies: managers, creditors, employees, and the community.⁸¹ The most vulnerable from that list would seem to be small creditors⁸² and employees, especially lower-level employees, where it is either impossible or irrational for them to protect themselves fully through closely negotiated contractual terms or covenants.

There is, of course, a way of protecting one's firm-specific capital investment other than through complex contractual terms and expensive covenants, and that is by pricing. An employee, for example, can protect a firm-specific capital investment by demanding higher compensation to pay

accompanying textual discussion. 'The effect of the Advocates' rule is that the shareholders are no longer the sole beneficiary of corporate managers' fiduciary duties. *See supra* note 66. A system in which directors are obliged to act in the best interests of some combination of corporate stakeholders while corporate officers, to whom the directors delegate the authority to run the day-to-day operations of the corporation, are obliged to act only in the best interests of shareholders would seem to be irrational, unintelligible, and unworkable.

80 Blair & Stout, *supra* note 11, at 255 (noting their proposals "*may . . . provide an efficient . . . solution*" (emphasis added)); *id.* at 283 (concluding that corporate constituencies under their regime "*may in some cases gain more from constraining shirking and rent-seeking than they lose to agency costs*" (emphasis added)); *id.* at 284 ("*[I]f the likely economic losses to a productive team from unconstrained shirking and rent-seeking are great enough to outweigh the likely economic losses from turning over decisionmaking power to a less-than-perfectly-faithful hierarch, mediating hierarchy becomes an efficient second-best solution to problems of team production.*" (emphasis added)). Individually, Professor Stout has stated that "the question ultimately cannot be answered except on the basis of empirical evidence. . . . For now, at least, I doubt that academics can provide a definitive answer." *See Stout, supra* note 11, at 1201.

81 *See supra* note 76 and accompanying textual discussion.

82 In *Metropolitan Life Insurance Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504 (S.D.N.Y. 1989), the court refused to provide extra-contractual rights to lenders under a corporate indenture, due in part to the fact that the lenders were sophisticated financial institutions and thus able to protect themselves by contractual terms. *Id.* at 1508.

her for the risk of expropriation of her firm-specific investment. Some may believe, contrary to the Advocates, that the availability of contractual terms or covenants and pricing generally result in efficient outcomes between, for example, employees and the company.⁸³

It is, however, the third of the above factual assumptions that likely will generate the most doubt. The Advocates' assumption is that a non-shareholder constituent who *recognizes* that his *efficient* firm-specific investment may be vulnerable to expropriation will respond by refusing to make the investment. This assumption seems questionable. Instead, the more reasonable assumption—provided the investment is *efficient* (i.e., it creates economic value) and the non-shareholder constituent *recognizes* the risk—may be that the member of the non-shareholder constituency will search for ways to protect his investment, and in many cases there is a likelihood that he will find ways to protect his investment for costs that are less than the transaction costs he encounters in dealing with the risk of expropriation. Specifically, once he *recognizes* the risk, he may see the opportunity to generate gain for himself by making the firm-specific investment and protecting himself by contract or pricing.

Consider the following illustration. Assume that I am a potential employee and I have two job offers. Firm A offers me a job that has an expected compensation of \$100, and that job does not require me to make firm-specific capital investment. Firm B offers me a job that has an expected compensation of \$120, but to take that job I have to make a firm-specific human capital investment of \$10, say in training that would only be useful within Firm B. Once I recognize in the Firm B job offer the risk of expropriation, my rational response is to take the job in Firm B and then spend up to \$10 protecting myself either by contract or by pricing and thus self-insuring. The point is that once I recognize that I am at risk—a fact that is essential to the Advocates' claim that non-shareholder constituencies will under-invest in firm-specific capital because of the risk—my rational response seems likely to be to contract for protection or to self-insure, unless the costs of those alternatives exceed the value of the difference between the pay I receive in the two jobs. Dealing with a *known* risk by refusing to engage in a value-creating transaction may seem an unlikely response in most cases.

Another factual assumption that is necessary to support the gains envisioned by the Advocates involves the incentives of directors operating

83 In Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984), the author discusses employment at will and the vulnerability of employees under that arrangement. He states that “we are dealing with the routine stuff of ordinary life; people who are competent enough to marry, vote, and pray are not unable to protect themselves in their day-to-day business transactions.” *Id.* at 954. He adds that there is no “reason to believe that such contracts are marred by misapprehensions, since employers and employees know the footing on which they have contracted.” *Id.* at 955.

under their regime. The Advocates assume that once directors are free of any legal duty to act in the best interests of shareholders, they will lose their incentive to make decisions that benefit shareholders at the expense of other non-shareholder constituencies and will become incentivized to maximize the total value of the privileged constituencies as a whole.⁸⁴

Once again, these factual assumptions seem problematic. Even if directors are freed of any *legal* duty to act in the best interests of shareholders, directors may still have strong economic incentives to make decisions that benefit shareholders at the expense of non-shareholder constituencies. The most obvious example is the fact that shareholders elect directors and can vote them out of office if they choose.⁸⁵ While scholars have rightfully pointed out the difficulty shareholders have in removing displeasing directors,⁸⁶ the matter is a bit more complex.

The market for directors, as well as the directors themselves, may measure a director's performance by the company's stock price. Thus, a director's claim for additional compensation from his company⁸⁷ and his ability to move up in the market for directors may well depend on his success, as measured by the company's stock price.

A related point is that the directors themselves may be stockholders and, especially in recent times, may hold stock options or restricted stock, which they are awarded as a part of their compensation package.⁸⁸ This further adds to the incentive directors have to expropriate the firm-specific investments of non-shareholder constituencies for the benefit of shareholders.

Finally, there is the matter of the market for corporate control. A low stock price enhances the risk of a successful unfriendly takeover bid, which will likely cost directors their jobs. As a result, directors operating under the Advocates' regime will continue to have the incentive to increase stock prices by expropriating value from non-shareholder constituencies for the benefit of shareholders. Such expropriation will protect their control of the company and the benefits of their directorships.

Even, therefore, with no legal duty to maximize shareholder wealth, there remains a powerful and quite visible complex of incentives for directors to grab rents and expropriate value on behalf of the company's shareholders.

84 See *supra* text accompanying notes 75-79.

85 MODEL BUS. CORP. ACT § 8.08(a) (2006).

86 See, e.g., Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 732 (2007) ("The shareholder franchise is largely a myth. Shareholders commonly do not have a viable power to replace the directors . . .").

87 Under the MODEL BUSINESS CORPORATION ACT, directors set their own salaries. MODEL BUS. CORP. ACT § 8.11 (2006).

88 See KORN/FERRY INT'L, 33RD ANNUAL BOARD OF DIRECTORS STUDY 18 (2006), available at <http://www.kornferry.com/Publication/3322> ("The vast majority (ninety-four percent) of FORTUNE 1000 companies use equity as a portion of director compensation."); see, e.g., GEN. ELEC. CO., SCHEDULE 14A, *supra* note 60.

If that is the case, it seems unlikely that non-shareholder constituencies will feel markedly more secure in a world in which directors are freed of any *legal* obligation to act solely in the best interests of shareholders. Fully informed non-shareholder constituencies may well perceive little change in their vulnerability.

The Advocates also make a critical factual assumption regarding the low costs of their regime. This assumption is necessary to support any final factual reckoning that the economic costs of their regime are less than the efficiency gains the regime generates.

The Advocates, certainly, make no claim that their regime changes the inherent inclination of directors to act as rational maximizers in furtherance of their own self-interests.⁸⁹ Thus, the net gain of the Advocates' regime depends on an assumption that rational directors operating without a mandate to act in the best interests of shareholders will not divert untoward amounts of corporate value to themselves⁹⁰ or otherwise mismanage or undermanage the corporation. Stated differently, the net benefit of the Advocates' regime depends on the factual assumption that freeing directors from any standards in this matter will not raise the agency costs associated with the directors' function, at least not to an unacceptable level.

Sustaining this assumption is challenging, however, since the Advocates' regime may generate significant agency costs by providing directors a prodigious cover that enables them to pursue their own self-interests at the expense of the corporation.

Consider two examples. First, assume that Target Corporation's board receives an offer from Bidder Co. for the acquisition of Target at a 50% premium over the current market price of Target's common stock. The Advocates' regime provides a cover for self-interested acts by Target's directors, who may be interested in protecting their directorships. The Advocates' regime enables the Target directors to resist what appears to be a value-enhancing overture, claiming that the proposed acquisition jeopardizes the interests of the company's employees and creditors (if there is a leveraged acquisition) and the community. Even in the face of an offer that amounts to a large premium over market value—which would suggest the acquisition will increase the economic value for the corporation as a whole—the Advocates' regime makes it unlikely that a court would ever

⁸⁹ See Blair & Stout, *supra* note 11, at 316.

⁹⁰ As described earlier, the Advocates recognize that directors under their regime would be subject to duty of loyalty requirements that would prohibit directors from transferring wealth from other constituencies to themselves by stealing. See *supra* note 65 and accompanying textual discussion. The Advocates posit, however, that this may apply “to only a very limited subset of all the possible situations” involving deep conflicts of interest. Blair & Stout, *supra* note 11, at 299. This amounts to a significant limitation on the protection offered by the duty of loyalty against directors' self-serving transactions. See *infra* notes 92 and 93 and accompanying textual discussion.

find such defensive actions culpable.⁹¹

Consider another example involving the highly visible and contentious issue of salaries for senior officers, particularly CEOs. The very heart of the gains envisioned by the Advocates in their regime depends on the unfettered right of a board of directors to allocate “rents” among the privileged constituencies, and executive officers are always at the center of such constituencies.⁹² As a result, the Advocates’ regime would empower a board—without any accountability or limitation—to shift essentially unlimited amounts of corporate value to the CEO or other senior officers in the form of compensation.⁹³

These two simple examples suggest that the additional agency costs of the Advocates’ regime—especially when combined with a lax business judgment rule—are significant. Directors operating under the Advocates’ regime would be free from the discipline generated by the threat of lawsuits for their mismanagement and also would be substantially less vulnerable to the discipline generated by the market for corporate control.

In summary, the Advocates’ justification for their argument that directors should be permitted to make unlimited wealth transfers among corporate stakeholders depends on a number of factual assumptions that seem problematic, including the following:

- (1) That non-shareholder constituencies, recognizing their vulnerability to expropriation of their firm-specific investments, react by foregoing value creating trades;
- (2) That managers, freed of any legal obligation to act only in the best interests of shareholders, will no longer have a significant incentive to take actions that benefit shareholders at the expense of

⁹¹ Imagine, for example, a situation in which the bidder offers a 100% premium for the target’s stock. Under the Advocates’ regime, especially with an overlay of a lax duty of care standard under the business judgment rule, it would seem unlikely that a court would find that the directors violated their fiduciary duty by resisting the offer, if directors justify their action as protecting other constituencies. Although Professors Blair and Stout would subject directors to a duty to take actions that benefit the corporation as a whole, their view is that an allocation of rents among competing constituencies “cannot be overturned by appealing to some outside authority, like a court.” Blair & Stout, *supra* note 11, at 284; *id.* at 289 (finding directors’ “fiduciary obligations . . . run to the firm as a whole”); *id.* at 300 (arguing for liability under the business judgment rule “only . . . where a finding of liability serves the collective interests of all the firm’s members” (citation omitted)). Evaluated under a lax version of the business judgment rule, it would be nearly impossible for complaining shareholders to meet their heavy burden of proving that the judgment of the board to resist the unsolicited bid violates the board’s duty of care. *See supra* notes 12–15 and accompanying textual discussion.

⁹² The “joint welfare function” that defines the Advocates’ regime consists “primarily [of] executives, rank-and-file employees, and equity investors.” Blair & Stout, *supra* note 11, at 288 (emphasis added).

⁹³ *See id.* at 288; *see also id.* at 284 (explaining that an allocation of rents among competing constituencies “cannot be overturned by appealing to some outside authority, like a court”).

non-shareholder constituencies;

(3) That non-shareholder constituencies will recognize that managers owe no legal obligation to maximize shareholder wealth and will, as a result, believe that managers will not make decisions that benefit shareholders at their (non-shareholders') expense; and

(4) That directors, freed to make unlimited wealth transfers among constituencies, will not use the rule as a cover for self-interested actions, which include protection of their own jobs, unreasonably high salaries for CEOs, and general undermanagement of the company.

The net efficiency gains in the Advocates' regime depends on the *correctness of all of these assumptions*. A close analysis of their assumptions may suggest, however, that the likely outcome of the Advocates' regime is quite different from what they intend.

CONCLUSION

A strong version of corporate fiduciary duties promotes efficient and fair outcomes. Accountability on the part of corporate managers for their actions and decisions is integral to achieving these good results. Without a regime that includes strong fiduciary duties and accountability for the full value of the economic loss that results from managers' actions and decisions, achieving economic efficiency and fairness is less likely.

Society, however, seems no longer willing to enforce strong fiduciary duties or to require accountability for the full economic loss generated by corporate managerial misconduct.

Influential judges and scholars have provided the normative justification for this remarkable deterioration in corporate fiduciary duties. The justifications offered by Advocates for a weak fiduciary duty regime, however, are based on multiple factual assumptions that flounder when examined closely. The essential factual assumptions of the Advocates not only are unproven empirically but also are counterintuitive and seem to get only more factually improbable when unpacked and analyzed closely.

The arguments of the Advocates, therefore, fail to provide a sensible basis for abandoning the economic notion that holding actors liable for the full economic loss caused by their actions provides an incentive for efficient conduct. The Advocates fail to meet the burden of demonstrating a lax fiduciary duty regime promotes efficiency.

