2019

The Foundations of Anglo-American Corporate Fiduciary Law

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Book Review: *The Foundations of Anglo-American Corporate Fiduciary Law,* David Kershaw. [Cambridge University Press, 2018. xxx + 518 pp. Hardback £110.00. ISBN 978-11-07092-33-4.]

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Published in 78(1) *Cambridge Law Journal* 210 (2019)

How does legal doctrine form, why does it change, and why do doctrines with a common starting point, in legal systems with a shared heritage, diverge? David Kershaw addresses these questions by examining the development of corporate fiduciary law in the United Kingdom and United States. Kershaw charts the evolution of corporate fiduciary law in each system and, comparing the two, explains how and why the respective legal regimes evolved as they did. Though written for both UK and US audiences, the book weighs in on contested US scholarly debates, confronting the common claim that doctrinal change is less, or less directly, the product of internal logic or strict precedent than a response to extra-legal factors, including interest group politics, policy concerns, and state competition for corporate charters. Kershaw rejects this claim, offering alternative accounts for the production of US corporate fiduciary law and for Delaware's lead in attracting incorporations.

The book considers the evolution of four categories of directors' duties: business judgments, care, self-dealing, and corporate opportunities. In the English legal scholarly tradition, the analysis is precise and artfully phrased, with nuanced statements of law, close attention to the text of judicial opinions, and astute criticism. Perhaps more in the US scholarly tradition, the book also intervenes forcefully in debates with novel and provocative claims, tightly reasoned but expressed with less nuance. For example, while US scholars see Delaware as a system producing sophisticated corporate law, by dint of experienced judges and attentiveness to policy concerns, Kershaw sees it as a state that

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"fossilize[s]" fiduciary law (p. 19), borrows from other jurisdictions but "refus[es] to acknowledge external sources" (p. 81), and produces "significant legal contortion that generates a neutral substantive effect" (p. 220). The work is full of surprises for US-educated lawyers, who will quickly learn their debt to English law.

In four parts, one dedicated to each of the four categories of directors' duties, the book examines UK and US law in turn. Since US corporate law is a matter of state law, the book also considers differences across the most influential states, usually those that have attracted the most incorporations – before the early 1920s, New York, Pennsylvania, and especially New Jersey; and later, when it had won the "race for corporate charters," Delaware.

Let me briefly outline the book's comparison of how fiduciary law evolved in each system. Inevitably, this sketch fails to do justice to the book's rich development of ideas and its attention to competing viewpoints. Part I considers fiduciary constraints on directors' exercise of business judgment. These constraints find expression under UK law in the duty to promote the company's interests in good faith (the good faith duty) and under US law in the so-called business judgment rule (the BJR). The UK duty reflects the common law's approach to regulating the exercise of delegated power in multiple public and private law settings. Under this approach, courts deferred to the good faith exercise of delegated authority by fiduciaries, refusing to interfere with a fiduciary's errors of judgment where the fiduciary had exercised his or her authority in good faith.

A surprise for US scholars is that the contemporary BJR, a rule regarded as distinctively American, traces its origins to the UK good faith duty. In fact, nineteenth-century New York, New Jersey, and Pennsylvania courts relied on English authorities to articulate a rule that was "substantive[ly] congruen[t]" with English law (p. 74). It was not until the early twentieth century that Delaware law recognized this rule, although it then stated it consistently with English authorities and those of other states. Beginning around 1960, Delaware courts began expressing the rule differently, often requiring both good faith and rationality. Nevertheless, the regulation of business judgments in Delaware, the UK, and all other US jurisdictions was "remarkably consistent" and "generated very similar outcomes" (p. 131). In 1984, the Delaware Supreme Court in *Aronson v. Lewis*, 473 A.2d 805 (1984) reformulated the BJR, merging the fiduciary

duties of care and loyalty into the rule. To Kershaw, these changes were a "re-presentation" of existing law that created a new doctrinal structure, generating a range of confusing effects (p. 132); "the functional substantive product … [was] identical" (pp. 131-32).

In Part II, Kershaw examines directors' duty of care, observing that contemporary US law requires gross negligence while UK law ostensibly imposes a more demanding negligence standard. (For simplicity, the book adopts the US approach of regarding the duty of care as a fiduciary duty.) The surprise for US scholars is the extent to which their courts drew on trusts and especially bailment law. From the 1800s then-leading states adopted twin strands of authority (from bailment law) with competing understandings of a gross negligence standard. It was not until 1963 that Delaware analysed this duty in detail. It imported the duty of care from other states, taking from them "the very same ideas and dichotomies" (p. 224). In the 1980s, Delaware departed from this legal tradition, generating "jurisprudential contortions" (p. 199) and creating "significant legal uncertainty" (p. 225). Nevertheless, this contortion seems to have had little substantive effect, instead "fossilis[ing] rules produced elsewhere" (p. 226).

As for the UK duty of care, its origins also lie in bailment and trusts law. The duty purported to apply an ordinary, not gross, negligence standard, and yet its standard shifted according to directors' and companies' circumstances, producing a standard "substantially congruent" with one of the two understandings of gross negligence that proved influential in US law, including in Delaware (pp. 255).

Part III examines fiduciary limits on self-dealing. Again, the UK and US had identical starting points – here, a strict rule that prohibited self-dealing by directors in the absence of informed shareholder approval. However, the laws "rapidly diverged" (p. 285). Facing commercial pressure, UK courts gave effect to provisions in corporate constitutions that permitted self-dealing that the strict rule would otherwise prohibit; such provisions became common, easing the severity of the strict rule. Although US courts faced similar pressure, they did not regard constitutions as capable of varying the self-dealing rule, a position that reflected their conception of corporations as the product of legislative action rather than private contract. But they did respond. New Jersey introduced a fairness-based remedy for executed self-dealing transactions, a doctrinal

move seeded in English law. New York drew on the distinction in English fiduciary law between fiduciary power and influence, applying a fairness rule in place of the strict rule if an interested director exercised influence rather than power. Delaware imported New Jersey and New York law, conceptually fusing their different paths to fairness review but without making substantive legal contributions of its own. A surprise for US scholars is that fairness review is no recent innovation. Contrary to the dominant narrative, the principles were sourced from English law and deployed at least from the mid-nineteenth century.

Part IV turns to fiduciary law governing corporate opportunities. Again, UK and US corporate law drew on English fiduciary law. However, here the story of US law is one of "legal continuity," not change (p. 470). In *Guth v. Loft*, 23 Del. Ch. 255 (1939), the Delaware Supreme Court attempted to harmonize twin approaches that had become dominant in corporate opportunities doctrine in other states, adopting a four-factor test. Its efforts left "a deep conceptual indeterminacy at the heart of Delaware connected assets law" (p. 458). Delaware law nevertheless had "much in common" with the UK position until 1970 (p. 470), when UK law itself took an anti-director turn. The contemporary position, codified in section 175 of the Companies Act 2006, may be interpreted to reflect this recent anti-director bias, but Kershaw argues otherwise, contending that, understood in its historical context, the pre-1970 UK approach "*is* the common law position" and that the statute must be interpreted in light of this (p. 428).

In each part, after charting the evolution of law, the book interrogates how well scholarly accounts of legal change fit with the evidence. The analysis is broadly consistent across parts. First, did state competition for corporate charters drive changes in US corporate fiduciary law, as many contend? Kershaw's analysis plausibly undermines this explanation. The basic principles of corporate fiduciary law were in place before states began competing for charters in the late 1800s. When Delaware took the lead in attracting incorporations, it completely lacked corporate fiduciary law in key areas. Neither its law nor, by extension, the quality of its judiciary explains its success. That was instead the product of its small size and dependence on franchise taxes, factors that ensured Delaware would not upset the already palatable status quo that other states had established. Having won the race, Delaware developed a "*will* to claim authorship and

ownership of the legal concepts it deploys" (p. 199). It "borrowed [its corporate laws] wholesale… from other states", often without attributing its debt to them or English law, and it "fossilized" these laws (p. 19). While Delaware reformulated doctrines, these changes were "re-presentations" that generated "empty legal ideas" and "structural incoherence," "breed[ing] indeterminacy" (p. 20).

Kershaw similarly rejects claims that legal changes in nineteenth-century US law were the product of interest group politics, policy concerns, or ideological preferences. While courts were aware of economic pressures, for example, the law responded to these concerns "in limited and internally consistent ways – generating responsive solutions that were legally coherent and consistent" (p. 367). To Kershaw, these changes are better understood as the product of the interaction between early fiduciary law and, depending on the fiduciary context, moral or other ideas, such as the meaning of "property" or the nature of the corporation.

The book's conclusions significantly complicate, sometimes refuting, existing accounts of US corporate law production. Its analysis is deep and insightful. I am nevertheless left wondering about some tensions in the work. Can Delaware have fossilized fiduciary law, preserving the status quo, and also have so contorted fiduciary law, creating uncertainty and structural incoherence? Can Delaware's changes have produced indeterminacy while allowing it to continue winning the race for corporate charters? The book's claims are delicately balanced.

Some doctrinal claims will also face resistance. Many US scholars will see coherence in Delaware fiduciary law, pointing to its practical operation. Some may be confounded by the book's treatment of the BJR as distinct from the duty of care and the conception of the BJR as "never" having been a "barrier to the application of the duty of care" (p. 262). These claims are central to the book's structure, allowing it to consider business judgments and the duty of care separately, creating a neat parallel with UK law where these categories warrant distinct consideration. But so closely linked are the BJR and the duty of care that US scholars generally consider them inseparably: see Clark, *Corporate Law* (1986), pp. 123-24; Bainbridge, *Corporate Law* (3rd ed., 2015), pp. 107-15. The precise relationship is contested, and yet a prevailing view – in tension with the book's position – is that the application of the BJR insulates directors from liability for

breach of the duty of care. Still, the book acknowledges competing perspectives, requiring critics to come to grips with its ideas.

The book contains fewer summative statements of direct comparison between UK and US corporate fiduciary law than one might expect. But its careful analysis sheds light on the common narrative that, in comparison with UK law, US corporate law is more director-friendly, its directors' duties more lenient. That comparison may reflect how these systems allocate power between boards and shareholders, but whether it also characterizes corporate *fiduciary law* is less clear. I doubt it. Recall that the UK good faith duty and US BJR were "remarkably consistent," a position that Delaware's "contortions" would seem not to have significantly altered. The UK duty of care is "substantially congruent" with a core strand of corresponding US case law. The corporate opportunity doctrines had "much in common" until 1970, when UK law shifted, a change Kershaw rejects as against the weight of authority. As for self-dealing law, Kershaw describes how US courts came to require fairness whereas UK courts respected commonly used constitutional provisions that required less—that interested directors inform their fellow directors of self-dealing. As US lawyers know, Delaware courts rarely protect directorial self-dealing on fairness grounds; until relatively recently, the judicial decision to impose fairness review was regarded as "outcome determinative," so remote was the prospect that defendants could carry their burden of establishing the required procedural and substantive fairness. If we were to extend our analysis from fiduciary law's substantive content to its enforcement and deterrent effect, claims of US fiduciary law's greater leniency would look more doubtful still.

This book rewards close reading and re-reading. It deserves a wide audience.

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