The Practicality of Outreach Statutes Enforcing Directors' Duty of Care

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Enforcing Directors' Duty of Care

TABLE OF CONTENTS

I. The Feasibility of Class Actions ........................................ 906
   A. Advantages of the Class Device and Conditions for
      Class Certification ........................................ 906
   B. The Problem of Res Judicata .................................. 914

II. The Utility of a Broadened Shareholder Action:
Extending the Fiduciary Obligation in an Era of
Deregulation .......................................................... 918
   A. Overcoming the Generous Presumption and Standards
      of Due Care .................................................... 918
      1. The Business Judgment Rule ............................. 918
      2. The Limitations of Loyalty ............................... 922
      3. The Utility of Due Care .................................. 928
         a. Acknowledging the Existence of Negligence ....... 928
         b. The Practicality of Specifications .................. 934
         c. Incorporating the Substantive Aspect of Due
            Care ....................................................... 936

III. Rejecting the Contract Model ........................................ 942
   A. Countervailing Values ........................................ 943
   B. The Decline of Contract ...................................... 945
   C. The Intrusion of Reality ..................................... 948
   D. The Incentives of the Market ................................ 949
   E. The Interests of Federalism .................................. 951

IV. Conclusion ............................................................. 954

This article is a sequel to a proposal¹ for state legislation holding
directors of foreign corporations liable to resident shareholders for vi-
olation of the enacting state's duty of care. Under such legislation,
resident shareholders could personally recover for damages caused by
directors' negligence in connection with a major transaction.2 Should
a number of states adopt the statute, the proposal contemplates a mul-
tistate class action in which a court would apply the law of each state
in which a shareholder resides and assign damages accordingly. The
earlier piece sought to anticipate and overcome potential objections
grounded in constitutional principles and choice-of-law doctrine. Questions regarding the workability and desirability of the statute
were left for later exploration. This article addresses some of those
questions.
Part I seeks to demonstrate that notwithstanding plausible proce-
dural concerns, the shareholder multistate class action envisioned
by the statute could be managed by the courts. Even if the reach of a
state's fiduciary standard were thus extended, however, the duty of
care has traditionally been regarded as placing only slight demands on
directors' conduct. Therefore, Part II attempts to show how the direc-
tors' obligation to exercise due care could be reconceived as a potent
instrument for vindicating shareholders' interests. Finally, since the
proposed statute clashes with the contract model of the corporation
popular among current commentators, Part III raises and responds to
objections that could be brought under the contractual conception.
The article concludes that neither these objections, the conventionally
limited scope of directors' duty of care, nor the procedural hurdles of
class actions should stand in the way of a legislature seeking to estab-
lish locally enforceable duties toward injured resident investors.

I. THE FEASIBILITY OF CLASS ACTIONS

The shareholder multistate class action raises a number of practi-
cal questions of administration. These include difficulty in ascertaining
appropriate occasions for bringing suit in this form, accurately
identifying the adversely affected class, and ensuring the fair and
binding application of the laws of several states. Nevertheless, this
type of suit appears to be the most effective means by which a state
may protect resident shareholders without encroaching on the prerog-
avatives of the incorporating state.

A. Advantages of the Class Device and Conditions for Class Certification

Admittedly, whether a claim should be brought in a direct or deriv-
ative action is not always readily apparent.3 Derivative suits are
brought to redress "a wrong to the incorporated group as a whole that
depletes or destroys corporate assets and reduces the value of the cor-

2. See id. at 807-11.
3. See Aobelov v. Symonds, 156 A.2d 416, 420 (Del. Ch. 1959)(distinction between
derivative and personal causes of action "often a narrow one").
To state an individual claim, a shareholder "must allege either 'an injury which is separate and distinct from that suffered by other shareholders,' or a wrong involving a contractual right of a shareholder . . . which exists independently of any right of the corporation." Obvious instances of injuries suffered by shareholders *qua* shareholders include interference with voting rights, the fraudulent inducement of the sale of stock, and impairment of the plaintiff's relative position among shareholders. On the other hand, allegations of corporate mismanagement and of diversion of funds in connection with a cash-out merger have been held to present only derivative claims. Among the most clear-cut occasions for direct actions are those in which one formally denominated class of shareholders is pitted against another or those in which the directors are charged with failing to provide adequate disclosure. Other claims, such as allegations that directors have sold their corporate offices or improperly

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10. In Zahn v. Transamerica, 162 F.2d 36 (3d Cir. 1947), for example, Class A stockholders challenged the forced redemption of their stock. The redemption was issued at the behest of the Class B stockholder, and excluded the Class A stockholders from participation in the lucrative liquidation of a subsidiary. *Id.* at 38-40. Although the suit was successfully maintained against the Class B stockholder, "[w]ithout doubt, the directors also would have been liable to the shareholders." Carter, *infra* note 25, at 833. See also Phillips v. Insituform of North America, Inc., 13 DEL. J. CORP. L. 774 (Del. Ch. 1987)(board reduced proportion of Class B shares held by the plaintiffs to 49% by authoring the sale of additional shares, approved by-law changes increasing the power of Class A shareholders, and took other actions designed to prevent plaintiffs from controlling the corporation).
12. Compare Perlman v. Feldman, 219 F.2d 173, 178 (2d Cir. 1955), cert. denied, 349 U.S. 982 (1955)(minority shareholder may recover directly from majority shareholder for premium received for sale of controlling shares) with Haberman v. Murchison, 468 F.2d 1305, 1314 (2nd Cir. 1972)(portion of price received that is
withheld the declaration of dividends,\textsuperscript{14} have divided the courts over the nature of the suit.

In most instances, the characterization of claims brought under the proposed statute as direct actions should arouse little dispute. Allegations of director negligence in connection with a change in control of the corporation typically involve a decline in the value of the plaintiffs' shares that can be distinguished from harm to the corporation itself; the plaintiffs have suffered a distinct injury not shared by outside creditors of the corporation. It is well-settled, for example, that attacks on the terms of a merger may be brought by shareholders in their own right.\textsuperscript{15}

Unlike a derivative suit, the shareholder multistate class action does not necessarily displace the \textit{lex incorporationis}. A class action would apply the fiduciary standard of each enacting state to the extent of that state's interest in the action, as measured by the shares held by residents of the state. By contrast, the derivative suit seeks to vindicate the unified interest of a single entity: the corporation itself.\textsuperscript{16} For that reason, the variation in claims and apportionment of damages found in class actions are not available in a derivative suit. The unitary character of derivative actions dictates that application of a law other than the \textit{lex incorporationis} and in a derivative suit entails rejection of the law of the incorporating state. Besides representing a departure from the internal affairs doctrine,\textsuperscript{17} this course would not offer a principled basis for determining the state whose law would govern the suit. In theory, this problem could be overcome by bringing a series of actions. However, the firmly entrenched rule of res judicata in derivative suits\textsuperscript{18}—stemming not only from the conceptual


\textsuperscript{17} The doctrine provides that issues arising out of internal corporate relationships are governed by the law of the state of incorporation. See P. John Kozyris, \textit{Corporate Wars and Choice of Law}, 1985 \textit{Duke L.J.} 1, 15.

\textsuperscript{18} Auerbach v. Bennett, 393 N.E.2d 994, 998-99 (N.Y. 1979). See Debra Pulenskey Drescher, \textit{Note}, \textit{The Effect of Res Judicata on Shareholder Derivative Actions in
unity of the corporate personality, but also from the burdens and harms that successive suits would produce—affectively compels the selection of one state law.

Class actions also enable plaintiff shareholders to avoid the procedural obstacles to derivative suits erected by numerous states. For example, compliance with the law of the state of incorporation might require the plaintiff to make demand on the corporation's directors or shareholders before initiating a derivative suit. A potentially more onerous requirement is the posting of security for expenses that may be incurred by directors in defending against a derivative action. Even more drastically, the authority vested in special litigation committees by some states' laws may cause a derivative action to be terminated altogether.

While thus offering procedural advantages to plaintiffs, the proposed statute's provision for direct actions benefits directors as well by limiting their exposure to liability. Unlike derivative suits, which may spring from allegations of any harm done to the corporation, direct


19. See Note, supra note 18, at 160.
22. See, e.g., N.Y. BUS. CORP. LAW § 627 (McKinney 1986).
24. On the other hand, statutory provisions for liberal indemnification of directors defending direct actions may render a successful class action a Pyrrhic victory. That is, shareholders' gain in compensation for their losses may be offset by the decline in the value of their stock as the corporate fisc is drained by payments to the directors or to the indemnifying insurance company. See Dale A. Oesterle, Limits on a Corporation's Protection of its Directors and Officers from Personal Liability, 1983 Wis. L. REV. 513, 573-74. However, the possibility of indemnification does not destroy the value of class actions for the violation of the duty of due care. When the class comprises fewer than all shareholders—as would occur where directors are liable only under the more stringent standard of some states—the recovery by the benefited shareholders would outweigh the diminution of their stake in the corporation. Even where all shareholders are potential beneficiaries, they may consider the award of present cash compensation sufficiently valuable to justify a class action. In contrast, the recovery in a successful derivative suit is assigned to the corporate treasury, where stockholders must share it with others who have claims on the corporation. If indemnification is allowed, then the derivative suit has been futile, for the corporation is simply returning to directors money that it has just extracted from them.
actions must assert the violation of a duty owed specifically to shareholders. Traditionally, courts have been reluctant to acknowledge the existence of such duties except in carefully limited circumstances.\(^{25}\) By confining its scope to direct actions, the proposed statute substantially reduces the likelihood of unleashing a flood of litigated challenges to directors' conduct.

The principal context in which courts have been willing to entertain direct actions—changes in control of the corporation—is the focus of the proposed statute. It is on this battleground that shareholders are most likely to mobilize as a class\(^ {26} \) (though often unsuccessfully on the merits\(^ {27} \)) to enforce obligations owed directly to them. Since challenges to shifts in control frequently allege prejudice to the interests of minority shareholders,\(^ {28} \) these claims are especially suitable for class treatment.

Nevertheless, enactment of the proposed statute might provoke


\(^{26}\) See, e.g., Hanson Trust PLC v. ML SCM Acquisition, Inc. 781 F.2d 264 (2nd Cir. 1986)(violation of due care in board's approval of lock-up option agreement); Revlon, Inc. v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986)(defensive measures taken by board to avert hostile takeover did not meet directors' fiduciary duties to shareholders); In re Shoe-Town, Inc. Stockholders Litig. 1990 Del. Ch. LEXIS 14 (allegation in class action that directors failed to inform themselves or sufficiently participate in negotiations leading to "going private" transaction stated cause of action for which relief could be granted).


states with a different philosophy of fiduciary duties to create obstacles to class certification. A state that has attracted substantial incorporation—Delaware being the most notable example—could attempt to preclude suits under the statute by adopting an exceedingly narrow conception of direct actions. Under the traditional rule that the *lex incorporationis* determines whether an action is direct or derivative, potential plaintiffs would be deprived of the class vehicle that is central to the statute. However, the same interests that entitle a state to follow its own substantive notions of fiduciary duties also justify its disregard of artificial doctrines designed to thwart the advancement of those interests. Otherwise, a state of incorporation could defeat most outreach provisions simply by erecting insurmountable procedural barriers in areas of traditional deference to the *lex incorporationis*. Perhaps recognizing this danger, a New York court has indicated that it could grant class certification to shareholders of a Delaware corporation in a suit before it even if Delaware law would not.

A more serious set of concerns arises from the potential heterogeneity of the class of shareholders bringing suit under the proposed statute. Since various states may impose disparate fiduciary duties, a court might be required to apply a multiplicity of standards. As a result, directors might be found liable to residents of some states but not to others or even subject to varying measures of damages. These divergences appear to be in some tension with class action statutes' demands for uniformity, especially the prerequisites that "questions of law or fact common to the class" exist and that "the claims or defenses of the representative parties are typical of the claims or defenses of the class." This type of suit would also clash directly with the Restatement's exclusive assignment of suits by dissenting shareholders to the state of incorporation for the purpose of ensuring "uniformity in the recoveries" and "equality of treatment."

Although concerns about the feasibility of discrete statewide subclasses are legitimate, the Supreme Court has already rejected them as automatic grounds for denying class certification. *Phillips Petroleum v. Shutts* upheld the authority of a Kansas court to administer a class

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31. *See* Schneider v. Lazard Freres & Co., 552 N.Y.S.2d 571, 573 (Sup. Ct. 1990). The New York suit was brought against New York investment bankers, rather than the corporation's board, for their allegedly negligent advice concerning an auction of the corporation. The court stayed the suit because of the possibility that the outcome of a Delaware action against the board might effectively preempt the action against the bankers. *Id.*
action arising out of claims in eleven different states\textsuperscript{35} and presumably governed by as many different state laws. While the Court did not grant a blanket imprimatur to all multistate class actions involving varying state laws, \textit{Shutts} does signal sympathy for this device where the alternative is that most of the plaintiffs "would have no realistic day in court."\textsuperscript{36}

Still, it may be argued that sorting a limited number of shareholder groups, all of whose claims are governed by a single regime, presents a far more manageable task than discerning and applying the diverse fiduciary laws of several states. \textit{Shutts} itself observed that compliance with constitutional requirements for choice of law would sometimes be rendered "more difficult or more burdensome" by the "large number of transactions which the state proposes to adjudicate and which have little connection to the forum."\textsuperscript{37} Decisions since \textit{Shutts} have based their denial of class certification principally on the difficulties of applying the variety of pertinent state laws.\textsuperscript{38} In the case of shareholders' claims for negligence, some courts might feel similarly ill-equipped to interpret the numerous state laws involved.\textsuperscript{39} Conversely, a forum might eagerly seize upon the liberal jurisdictional


\textsuperscript{36} Id. at 809. Moreover, in resolving disputes over fundamental changes, courts have already had to distinguish the rights and interests of various groups of shareholders. Often it has been a simple matter of disqualifying shareholders who benefited from a challenged transaction from the recovery that may be enjoyed by those who did not benefit. \textit{E.g.}, Borak v. J.I. Care Co., 317 F.2d 838 (7th Cir. 1963), \textit{aff'd}, 377 U.S. 426 (1964); Perlman v. Feldman, 219 F.2d 173 (2d Cir.), \textit{cert. denied}, 349 U.S. 952 (1955); Zahn v. Transamerica, 162 F.2d 36 (3d Cir. 1947). In those instances, of course, the dissenting shareholders have all stood in the same relationship to the defendant. Even where plaintiff shareholders have differed in the nature of their claims, \textit{see}, \textit{e.g.}, Randle v. Spectran, 129 F.R.D. 386, 391-92 (D. Mass. 1988), however, or where courts have identified rights peculiar to a limited segment of stockholders, \textit{see} Hastings-Merthel v. Texas Air Corp., 119 F.R.D. 450, 458-59 (S.D. Cal. 1988); \textit{In re Resorts Int'l Shareholders Litig. Appeals, Fed. Sec. L. Rep. (CCH) ¶ 95,408 (Del. 1990) class treatment has been allowed if the representative shareholders appear able to assert adequately all the claims presented.}

\textsuperscript{37} 472 U.S. 797, 821 (1985).


\textsuperscript{39} \textit{See} Bresson v. Thomson McKinnon Sec., 118 F.R.D. 339, 344 (S.D.N.Y. 1988)(denying class treatment to investors' negligence claims against brokerage firm because of significant variations in state law).
reach conferred by *Shutts* to implement its own policy under the guise of construing other states' laws; the imprecise nature of the duty of due care may especially lend itself to such distortion.

The problems of difficult or tendentious construction, however, do not make shareholder multistate class actions for lack of due care inherently impractical. Many courts since *Shutts* have refused to permit differences in state law to defeat class certification. In most key respects, a typical shareholder's claim of negligence resembles the cases in which certification has been granted more than the cases in which certification has been denied. In contrast to some products liability cases where certification has been denied, the conduct that shareholders complain about springs from a single episode and inflicts the same type of injury on all of the plaintiffs. Likewise, the common nature of the shareholders' allegations is mirrored by the centrality of the directors' defense, a factor that weighs heavily in the class certification decision.

Moreover, the substantial variation in state laws which has deterred certification in some cases would probably not occur among outreach fiduciary statutes. States that chose to protect resident investors in this manner would inherently share a similar philosophy about the nature of directors' duty of due care. Accordingly, the statutes could be expected to resemble each other in most or all of their significant provisions. Indeed, the statutes' conscious purpose of facilitating multistate actions would discourage variation in details that would hinder the ability to bring class suits. To the extent that differ-


41. See Miller & Crump, *supra* note 34, at 61-64.


ences arose, they would probably lie in details that would be sufficiently specific and ascertainable so that they would not defeat a court's ability to coordinate and administer all the enacting states' laws. In addition, choice of law problems that have sometimes militated against class certification would not present an obstacle because the statutes themselves would set forth their explicit and compatible selections of law.

B. The Problem of Res Judicata

Perhaps the most difficult and complex questions raised by *Shutts* pertain to the res judicata effect of a judgment in a shareholder class action. One of the principal underpinnings of res judicata—shielding the defendant from vexatious lawsuits—takes on a special focus in the corporate setting. Subjecting directors to several suits for the same conduct, perhaps with officers summoned as witnesses, threatens to disrupt corporate operations. If the proposed statute is adopted by numerous states, disruption might result from competing or successive shareholder class actions. *Shutts* does not altogether preclude this possibility. While the Court endorsed the defendant's interest in binding the entire plaintiff class by res judicata, the opinion did not formulate a firm rule for claim preclusion. Ultimately, however, the special danger of multiple suits posed by shareholder multistate class actions is probably more theoretical than real.

The first of the troubling but surmountable problems that might arise from the enactment of several fiduciary statutes is certification of the same shareholder class by courts in more than one state. If no means could be agreed upon for selecting a single forum for a consolidated suit, then two or more substantially identical actions could proceed simultaneously. In addition to imposing significant costs and burdens, this development might provoke a "race to judgment" among the competing representatives of the shareholder class. This type of race would invite tactical maneuvers that aggravate the inherent strains of redundant litigation, as well as retard the truth-seeking

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45. The need for notice and administrability would require that an outreach statute be couched in more specific terms than the ordinary formulation of the director's duty of due care. See Stern, *supra* note 1, at 807-11.
47. See JACk A. FRIEDENTHAL et al., CML PROCEDURE 615 (1985)(most important purpose of res judicata is to "provide repose for both the party litigants and the public").
48. See Note, *supra* note 18, at 1058.
50. See Miller & Crump, *supra* note 34, at 36.
51. Id. at 23-24.
52. Id. at 24.
Another potential source of duplicative—but not necessarily competing—suits is the opportunity for shareholders to "opt out" of an action against directors. *Shutts* appears to grant absent plaintiffs an unlimited right to opt out of a class action. Even if the ruling is confined to actions authorized by Federal Rules of Civil Procedure 23(b)(3) or a comparable state provision, an action brought under the proposed fiduciary statute might fall into that category. Like the plaintiffs in *Shutts*, whose common claim of entitlement to interest on royalty payments was governed by the law of eleven different states, plaintiff shareholders would rely on a common allegation of negligence which would be resolved by the law of each state where a shareholder resides.

Conceivably, some shareholders might be tempted to opt out of a class action in order to improve their chances of recovering in a later action. By waiting for the outcome of the initial litigation, those shareholders could gain valuable insight as to the most effective way to position themselves in a subsequent suit. If the original class action was successful in establishing directors' liability, the shareholders who opted out of the class action could support their own claim with that result. Conversely, if the first suit failed, shareholders who declined to participate as class members would in theory not be bound by that judgment. With the benefit of observing the weaknesses of the earlier suit and perhaps the attitude of a particular court toward the out-

53. *Id.*

54. Phillips Petroleum v. Shutts, 472 U.S. 797, 812 (1985). While *Shutts* limited its holding to actions for money damages, pursuit of such relief is inherent in a suit under the proposed fiduciary statute. *Id.* at 811 n.3. Moreover, even if equitable relief might be desirable under some unusual circumstance, recognition appears to be growing in state courts that considerations of fairness and due process make an opportunity for absent class members to opt out appropriate there as well. See Kurt A. Schwarz, Note, 68 Tex. L. Rev. 415, 432-36 (1989).

55. Section 23(b)(3) allows class actions where a court finds "that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy." It has been suggested that the *Shutts* Court did not intend to preclude mandatory class actions under Rule 23(b)(1). See Miller & Crump, *supra* note 34, at 39, 54.

56. See Vaughter v. Eastern Airlines, 817 F.2d 685, 690 (11th Cir. 1987) (right to opt out is "available only in Rule 23(b)(3) actions"); MOORE'S FEDERAL PRACTICE § 23.446 (describing suit in *Shutts* as "common-question class action"). But see Penson v. Terminal Transport, 634 F.2d 989, 993-94 (5th Cir. 1981) (even though neither Rule 23(b)(1) nor Rule 23(b)(2) confers right to opt out, court may "mandate such a right pursuant to its discretionary power"); accord Cox v. American Cast Iron Pipe, 784 F.2d 1546, 1554 (11th Cir.), *cert. denied*, 479 U.S. 883 (1986).

57. See Johnson v. City of Baton Rouge, 50 F.R.D. 295, 300 (E.D. La. 1970); MOORE'S, FEDERAL PRACTICE § 23.31(1) (judgment in class suit brought pursuant to FRCP 23(b)(3) not res judicata as to members of class who opt out).
reach statute, these shareholders might be able to mount a more effective action in a more sympathetic jurisdiction.

Nevertheless, however unsettling the prospect of competing or successive suits, these appear to present principally hypothetical threats. Various devices exist for avoiding or mitigating duplicative litigation. Further, as a practical matter, the strategy of forum shopping that might motivate duplicative actions in other contexts does not offer much benefit here. Any states that enacted a fiduciary outreach statute would obviously share a similar philosophy of directors’ responsibility, thus reducing the utility of pursuing multiple forums. On the other hand, if one state’s courts proved especially favorable to shareholders’ suits, then the desirability of bringing suit there would undercut the attraction of other forums. The relative meagerness of shareholders’ resources and of individual stake in the outcome—conditions that prompt resort to the class vehicle in the first place—make it unlikely that plaintiffs would squander those resources on redundant actions promising so little advantage. Indeed, these considerations seem to operate generally to deter the proliferation of class actions over the same question: the specter aroused by Shutts of an eruption of duplicative actions does not appear to have materialized.

Moreover, any ploy by shareholders to opt out in order to use the initial class action as a trial run would probably encounter a chilly judicial reception. Suspicion that shareholders opted out as a cynical tactic rather than from good-faith concerns about adequacy of representation could lead a court to deny certification of the second action. Resistance to certification might be especially pronounced where the court believed that the shareholders promoting the later action were acting in concert with those who brought the original suit.

On the other hand, the most likely motivation for shareholders’ flight en masse from an initial class action is also one of the most legitimate. If a suit were brought in the state of incorporation and that state had conspicuously lax fiduciary requirements (a probable reason for incorporation there), many shareholders—certainly those residing in states with an outreach statute—would naturally prefer to press their claims in a more sympathetic forum. Since the very purpose of the statute proposed here is to provide recourse from insufficient standards of responsibility, pursuit of an alternative class action under

59. See id. at 516-17, 556-57.
60. See id. at 513.
61. Hostility toward such exploitation of the right to opt out is reflected by a proposal to amend Federal Rule of Civil Procedure 23(c)(2) to curb the ability of those opting out to rely on an earlier judgment for purposes of offensive estoppel. American Bar Association Section of Litigation, Report and Recommendations of the Special Committee on Class Action Improvements, 110 F.R.D. 195 (1986).
these circumstances would represent a valid exercise of the right to opt out. As long as all departing shareholders migrated to the same forum, most of the problems of burgeoning litigation would not arise.

While it is true that even a single additional suit compromises judicial economy, the second suit in this case would not be truly duplicative. Rather, assuming that the state of incorporation would apply its own law to all shareholders' claims, an alternative action would offer the only means of pressing claims brought under more stringent fiduciary regimes. If the original action were brought as a derivative suit as well, a second action for direct recovery could raise problems of coordination and of allocation of damages; however, these problems do not appear drastically less manageable in this setting than when a court must deal with direct and derivative claims in a single suit.

Ultimately, even plausible concerns about administrability should not deter states from venturing the experiment of a fiduciary outreach statute. If experience were to confirm serious apprehensions about such legislation, then a state could readily repeal its statute at little cost. Conversely, experience might well demonstrate the ability of practical considerations to dissolve adverse theoretical possibilities. For example, plaintiff shareholders and defendant directors might discover a common interest in having the class action resolved in a single forum, perhaps in addition to the state of incorporation. This mutual aim could induce the parties to cooperate in order to overcome otherwise seemingly intractable obstacles.

If such cooperation were not forthcoming, however, even the worst-case multiple suits scenario is not so wholly unthinkable as to preclude a priori the enactment of fiduciary outreach statutes. Shareholder suits under outreach statutes might prove especially amenable to separate statewide actions, with the danger of redundant activities minimized by coordination of efforts among plaintiffs' attorneys. The various courts involved might agree upon a test case that would place other proceedings in abeyance. Finally, the problem of duplicative litigation might be largely alleviated if a suit under

62. See generally Stern, supra note 1, at 34-44, 60-64 (discussing lenient parameters of choice of law).

63. For an analysis of the advantages of a single proceeding, see George T. Conway, III, Note, The Consolidation of Multistate Litigation in State Courts, 96 YALE L.J. 1099 (1987). The principal disadvantage of most consolidation, state courts' unfamiliarity with other states' law, would probably present little difficulty in the instance of applying similarly worded and animated fiduciary outreach statutes. Id. at 1105-06.

64. After all, separate defendants in some cases of alleged wrongful injury or death already face separate suits with potentially inconsistent results.

65. See Miller & Crump, supra note 34, at 71-72.

the proposed statute is characterized as not being a Rule 23(b)(3) action. At least one court has made such a determination in an action for breach of directors' fiduciary duties, and accordingly refused to permit shareholders to opt out of the class.

II. THE UTILITY OF A BROADENED SHAREHOLDER ACTION: EXTENDING THE FIDUCIARY OBLIGATION IN AN ERA OF DEREGULATION

Traditional notions of negligence in the corporate setting, particularly the business judgment rule, embody a deep-seated reluctance to penalize directors for the harmful consequences of decisions ostensibly made in good faith. Moreover, Delaware's adoption of an additional statutory shield against directors' liability and its widespread emulation by other states suggest that proposals to increase the possibility of liability would encounter an inhospitable legislative reception. Nevertheless, principles of due care, with defensible modifications, can be incorporated into the proposed statute to provide a potentially effective mechanism for enforcing directors' duties.

A. Overcoming the Generous Presumption and Standards of Due Care

The application of the duty of care to directors of foreign corporations does not of course assure imposition of a higher level of responsibility. In addition to making exposure to liability for negligence mandatory, the proposed statute's substantive standard should hold some promise of penalizing lapses that might now be committed with impunity. Accordingly, it should be shown why the statute would offer more auspicious prospects for recovery than traditional actions for lack of due care.

1. The Business Judgment Rule

At first blush, a practically insurmountable obstacle to recovery in almost all actions under the proposed statute appears to be presented by the business judgment rule. Under the rule, directors making a business decision enjoy a "presumption" that they have "acted on an informed basis, in good faith and in the honest belief that the action..."
taken was in the best interests of the company.\textsuperscript{72} The rule reflects the philosophy that the structure of corporate governance confides responsibility for business decisions to management; the limited supervisory role of courts and shareholders does not extend to substituting their business judgment for that of directors.\textsuperscript{73} As a matter of policy, the rule tacitly acknowledges that courts lack the competence to pass on the wisdom of business decisions,\textsuperscript{74} and that routine judicial scrutiny of the merits of those decisions would chill legitimate entrepreneurial risk-taking.\textsuperscript{75} Applied rigorously, these rationales potentially confer a virtual blanket immunity on directors for decisions that do not implicate questions of divided loyalty.

Properly understood and applied, however, the business judgment rule should not bar effective review of board decisionmaking under the proposed fiduciary statute. While the rule may predispose courts to uphold the propriety of directors' conduct, it does not in any way diminish directors' duty of due care. On the contrary, the business judgment rule does not shield directors who have made "'an unintelligent or unadvised judgment’" or who have otherwise failed to obtain available information pertinent to their decision.\textsuperscript{77} The presumption of regularity dissolves when plaintiffs can demonstrate that the directors failed to observe the requirements of due care.\textsuperscript{78}

Equally importantly, the policies underlying the business judgment rule are less of a concern in transactions covered by the proposed fiduciary statute. While the business judgment rule properly counsels against inhibiting board deliberations by the constant threat of judicial second-guessing, the scope of the statute is tailored to avoid such interference. Because the statute would only apply to major transactions, decisionmaking by directors would not be paralyzed by


\textsuperscript{73} International Ins. Co. v. Johns, 874 F.2d 1447, 1458 n.20 (11th Cir. 1989); Rosenthal v. Rosenthal, 543 A.2d 348, 353 (Me. 1988); Corporate Director's Guidebook, 33 BUS. LAW. 1595, 1603-04 (1978).


\textsuperscript{76} Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)(citation omitted).

\textsuperscript{77} Id. at 893.

\textsuperscript{78} See Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 273 (2d Cir. 1986).
the specter of constant monitoring of daily activities. Moreover, concerns about providing adequate notice to directors are addressed by the statutory announcement that judicial scrutiny will only be brought to bear on major transactions.

More broadly, the types of negligence that directors are most prone to commit in connection with a fundamental change are more susceptible to judicial review than are ordinary exercises of business judgment. While judges may be ill-equipped to assess the advisability of selecting a particular product line or the site of a new factory, they lack neither the ability nor the experience to analyze whether directors devoted adequate care to a decision deeply affecting the corporation and its shareholders. On the contrary, enforcing procedural requirements and fiduciary responsibilities is a matter of peculiar judicial competence.

The capacity of courts to make a meaningful examination of the quality of board decisionmaking is confirmed by decisions finding a lack of due care. 79 When directors act with extreme haste or give cursory inspection to crucial documents, courts can hardly be considered to have violated their presumptive deference to business “expertise” by pronouncing these lapses as falling short of the legal standard of diligence. Lack of business credentials no more disqualifies judges from gauging the adequacy of directors’ care than the lack of a medical degree precludes juries from returning verdicts of medical malpractice.

Indeed, the comparison with negligence doctrine in the medical field suggests that rigid adherence to the business judgment rule may exaggerate the amount of respect owed to directors’ decisions. Unlike directors, physicians may not even legally practice their profession without having fulfilled prescribed, rigorous requirements of education and training. 81 This discrepancy in formal preparation may militate in favor of holding doctors and others with a similarly intense grounding in their profession to more exacting expectations; however, it also militates against basing a virtual talismanic immunity on the putative wisdom of directors. Wisdom is not prudence, and experience suggests that directors may sometimes lack both.

To some extent, the argument against judicial tampering with an inviolate sphere of business judgment is undermined by the nature of decisions typically involved in a fundamental change. When directors make ordinary decisions, the only question is whether their action will promote the welfare and profitability of the company. Absent evidence of divided loyalty or conspicuous irregularity, it makes sense to grant directors a generous presumption that their conduct was designed to advance these goals.

Neither of the two most probable grounds for judicial questioning of board decisions—a belief in the court's superior business acumen and the benefit of hindsight—affords a tenable basis for penalizing directors for what turns out to have simply been an excusable mistake. However, when the board's decision concerns a matter on which the entire future direction of the corporation may hinge, an overwhelming presumption in favor of the propriety of directors' conduct is no longer warranted. The very momentousness of the decision magnifies the consequences of a poorly made decision and hence the value of judicial scrutiny to ensure that adequate procedures are employed. An appreciation that their conduct may be subject to serious examination, and not viewed indulgently through the forgiving aura of "business judgment," could prompt directors to act with a due regard for the interests of shareholders.

A crucial consideration is that these situations characteristically tempt directors to give insufficient weight to shareholder interests. It does not require a formal conflict of interest to recognize that concern for their own position may distort directors' ability to make a careful and dispassionate assessment of the matter to be decided. In judging the validity of responses to hostile tender offers, for example, even the Delaware Supreme Court has acknowledged the "omnipresent specter" that a board might be influenced more by its own interests than by those of the corporation and its shareholders.\(^{82}\) Accordingly, the court has reduced the scope of the business judgment rule and increased the role of judicial review in evaluating the appropriateness of defensive measures.\(^{83}\) Admittedly, such concerns traditionally fall under the rubric of loyalty rather than due care and may be even less visible outside the setting of takeover bids. However, as shall be discussed,\(^{84}\) the conventional dichotomy between the duty of loyalty and the duty of due care offers too simplistic a method of dealing with the mix of motives and distractions that directors may experience in making decisions about a variety of fundamental transactions.

In a sense, close judicial supervision of directors' diligence under
the proposed statute would further a central purpose of the require-
ment of shareholder approval for most fundamental changes. That
requirement tacitly recognizes that some decisions cannot be en-
trusted to the normal operation of business judgment. If the question
in mergers and sales of assets were solely one of relative competence,
then the philosophy underlying the business judgment rule might jus-
tify reposing these decisions exclusively in the board of directors.
However, the requirement of shareholder approval serves not only to
implement tenets of corporate democracy but also to guard against the
possibility that a profound change (or resistance to change) in the cor-
poration will not be unduly influenced by directors' self-interest. Still,
just as shareholder approval gained through inadequate disclosure
does not place a valid imprimatur on a proposed change, so should
inadequate deliberation similarly taint a board recommendation and
any shareholder decision based upon it. In both instances the magni-
tude of the decision and the vulnerability of the process to abuse
should overcome the normal judicial reluctance to give close scrutiny
to board determinations.

2. The Limitations of Loyalty

In rebuttal to the above analysis, it could be argued that the duty of
loyalty already encompasses concerns about suspect zeal by directors
for the welfare of the corporation and its shareholders. Conversely,
the standard of due care's emphasis on procedural adequacy might be
regarded as too limited a tool for reaching the substantive harm that
lies at the bottom of a suit brought under the proposed statute. Both
observations raise serious objections. Established conceptions of loy-
alty, however, do not address every circumstance in which a signifi-
cant danger of unfairness may lurk. Notwithstanding the apparent
breadth of these principles, courts in practice have tended to confine
breaches of the duty of loyalty to obvious conflicts and severe harm,
while tolerating other injurious but less flagrantly self-interested be-
havior. Between the zone of obviously divided loyalty and that of
egregiously sloppy procedures lies a wide realm in which harmful and
arguably improper conduct may take place. Rather than tolerate such
a permissive concept of directors' autonomy, courts could adjust due
care doctrine to take into account the unfairness of a challenged
transaction.

85. E.g., DEL CODE ANN. 8, § 242(b)(1991)(amendment to certificate of incorporation);
    id. § 251(c)(merger or consolidation); id. § 271(a)(sale, lease or exchange of sub-
stantially all of corporation's assets); id. § 275 (dissolution).
86. See Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386-87 (1970); J. I. Case v. Borak,
87. The manner in which due care doctrine might be shaped is described infra notes
    182-224 and accompanying text.
It is true that traditional application of directors’ duty of due care furnishes little ground to perceive it as a powerful mechanism for enjoining responsible conduct. The relative sparsity of decisions ruling against directors purely on a theory of negligence underscores conventional judicial reluctance to enforce a stringent notion of due care. While Smith v. Van Gorkom and other decisions in its immediate aftermath finding director negligence might be seen as signaling a harsher doctrine, each case also involved a conspicuous lack of considered deliberation.

At the same time, the greater potency of substantive review under the duty of loyalty is undermined by limitations on that duty’s application and remedy. The differing outcomes of two well-known cases illustrate the limited reach of loyalty doctrine. In Globe Woolen Co. v. Utica Gas & Electric Co., the New York Court of Appeals had little difficulty striking down a self-dealing contract plagued by “startling” unfairness to one of the corporate parties. The invalidated agreement committed the defendant electric company to supply Globe with all of the electricity required to operate its textile mills. Under the disputed provision, Utica guaranteed Globe a fixed monthly saving over the cost that Globe had previously incurred using steam power. Largely because of changes in the type of dyeing done by Globe, the cost of supplying electricity turned out much higher than anticipated; indeed, Utica ultimately owed Globe money under the guarantee. The court’s scrutiny of the fairness of the transaction was triggered by the presence of a Mr. Maynard on both sides of the transaction. Maynard was president, director, and chief stockholder of Globe as well as

89. 488 A.2d 858 (Del. 1985).
91. See Block, supra note 72, at 729-44.
92. 121 N.E. 378 (N.Y. 1918).
93. Id. at 380.
94. Id. at 379.
a director of Utica. While Maynard did not actively participate in Utica's approval of the "one-sided" contract, the directors who voted for it were apprised of Maynard's endorsement of the transaction.

The court's holding that the bargain was fatally inequitable does not strain even relaxed notions of the requirements of loyalty or confidence in judicial ability to assess the merits of business deals. The conflict posed by Maynard's dual affiliation was real, not merely formal. Holding the principal shares in Globe and none in Utica, Maynard had a personal financial stake that lay entirely on one side of the transaction. Although Maynard neither voted nor spoke at the meetings in which the agreement was considered, the other directors' awareness of his recommendation deeply influenced their own approval. Maynard must have known of the likelihood that over the term of the contract (ten years) Globe would adopt changes necessitating an increase in its demand for electricity and hence making Utica's fulfillment of its guarantee prohibitive. Under the circumstances, his instrumental role in promoting the agreement and his failure to warn his fellow directors of the potentially "disastrous" consequences lurking within the guarantee violated elemental obligations of loyalty.

If it did not require a conception of loyalty with powerful "bite" for the New York Court of Appeals to relieve Utica of its onerous commitment, the court's later decision in *Everett v. Phillips* demonstrates how weak that bite can be. Unlike Maynard's somewhat restrained role in causing Utica to accept an improvident bargain, the aggressive conduct of directors sitting on both sides of the arrangement at issue in *Everett* visibly pervaded the entire transaction. There, the defendant directors of the Empire Power Corporation owned or controlled all of the corporation's common stock and substantial amounts of other classes of stock, while also owning or controlling a majority of the common stock of Long Island Lighting Company. The defendants had Empire make a series of what were ostensibly short-term loans to Long Island Lighting. In practice, however, Empire repeatedly extended the time of repayment so that the arrangement amounted

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95. *Id.* at 378.
96. *Id.* at 380.
97. *Id.*
98. *Id.* at 379.
99. See *id.* at 380-81.
101. *Id.* at 380.
102. 43 N.E.2d 18 (N.Y. 1942).
103. *Id.* at 21.
to a large, long-term unsecured loan to Long Island Lighting.104 At the time of the litigation, Long Island Lighting still had not paid back any of the sums that it had borrowed.

The court in Everett rejected the claim of a minority shareholder in Empire which challenged the directors' refusal to demand repayment of the loans. Yet, in almost any meaningful sense of loyalty, the directors improperly subordinated their responsibility to Empire to their stake in Long Island Lighting. Given the precarious financial state of Long Island Lighting,105 the subterfuge of indefinitely renewable short-term loans no doubt served the interests of that corporation and its shareholders. However, it served no discernible purpose of Empire, and little serious contention could be made that a director single-mindedly zealous for Empire's welfare would have displayed similar indulgence.106 Indeed, this case would have been more sensibly governed by the flip side of the business judgment rule. Just as an adverse result alone does not permit an automatic inference of negligence, neither should manifestly dangerous conduct be shielded by the fortuity that disaster has not yet befallen.

The Everett opinion particularly demonstrates how loyalty's concern with individual motive can distract courts from an appropriate analysis of fundamental fairness. The court noted that any loss accrued by Empire as a result of the loans would be suffered primarily by the defendants and that the defendants owned a greater proportion of Empire stock than Long Island Lighting stock.107 Presumably, the court cited those facts to establish that the defendants had a strong financial incentive to avoid actions that could be detrimental to Empire. Such speculation, however, seems ill-advised. The defendants certainly determined that the magnitude of the loss they might incur, absent on infusion of loans to prop up Long Island Lighting, was greater than the harm to which they were exposing themselves by refusing to collect on the loan made by Empire. Simply to state the calculation involved is to show that the defendants' self-interest did not coincide with that of the corporation on whose board they sat and whose welfare they obviously slighted.

104. See id. at 23 (Desmond, J., dissenting).
105. See id. at 21.
106. Likewise, the court's explanation of Long Island Lighting's reliance on the device of renewable short-term loans also seems to stray from the perspective of how a disinterested director of Empire could be expected to act. Issuance of bonds maturing later than one year would have required permission from the Public Service Commission, which might have imposed inconvenient restrictions as conditions to its approval. Id. Again, while evasion of such restrictions was certainly a relevant (if dubious) motivation for Long Island Lighting's access to funds, it is difficult to conceive of any advantage that this manoeuvre conferred upon Empire.
107. Id. at 22.
In addition, the significance ascribed by the court to one of Empire's charter provisions anticipated a lack of potency in the duty of loyalty. The provision stated that no transaction with another corporation "shall be affected or invalidated by the fact that" one or more Empire's directors or officers had an interest in or connection with the other corporation. The court conceded that the provision did not immunize transactions in which Empire directors held a "dual position" from careful judicial scrutiny. Nevertheless, the court opined that the express authorization to enter into such transactions had "the effect of exonerating the directors, at least in part, 'from adverse inferences which might otherwise be drawn against them.'" The weight accorded to Empire's charter provision in a sense prefigures Delaware's interested director statute and comparable legislation widely adopted elsewhere. Under section 144, a corporation's transaction with one of its directors, or with another corporation in which one or more of its directors sits or has a financial interest, is not voidable solely by virtue of the conflict situation if one of three conditions is met: disclosure to the board and good faith approval by a disinterested majority of directors, disclosure to and good faith approval by shareholders, or fairness of the contract to the corporation. While the statute on its face is framed in terms of minimum requirements for validity, in practice fulfillment of any of the stipulated conditions appears to create a powerful presumption in favor of the transaction. Delaware courts have held that satisfaction of one of the conditions imposes on dissenting shareholders a "difficult burden" to demonstrate the unfairness of the transaction. Thus, the stringent safeguard that the duty of loyalty once erected against the taint of director self-interest has been reduced to what may often amount to a mere procedural requirement. Even if it is psychologically realistic to expect technically "disinterested" directors to exercise truly de-

108. Id. at 20.
109. Id. at 22.
110. Id. (citation omitted).
 detached judgment,\textsuperscript{116} Everett suggests the ready accessibility of the other two avenues for judicial approval. The same majority of shareholders that installed the board of directors would presumably be strongly predisposed to ratify a transaction endorsed by the board. Certainly, shareholder approval is virtually a foregone conclusion in instances, like the scenario in Everett, in which interested directors are also controlling shareholders.\textsuperscript{117} In any event, if a showing of "fairness" can ultimately vindicate any transaction, the conception of that term embodied in Everett suggests that it poses a meager obstacle to even highly suspect self-dealing.

Moreover, the cramped notion of substantive unfairness that courts may harbor does not impose the only constraint on the potency of actions for breach of loyalty. "Fair dealing," the other principal demand of directors potentially compromised by self-dealing,\textsuperscript{118} also calls forth only a limited inquiry, at least in Delaware. For example, the relevance of tainted motivation for board action has declined, as evidenced by the Delaware Supreme Court's abandonment of the business purpose requirement for mergers.\textsuperscript{119} More importantly, inquiries with regard to loyalty have traditionally arisen only out of certain visible, specifically defined forms of conflict of interest.\textsuperscript{120} Thus, more subtle distortions of judgment may not evoke the heightened scrutiny theoretically triggered by conventional types of self-dealing. A possible response to this problem would simply be to adopt a more expansive concept of loyalty, but this seems a dim prospect in those states whose laxity has prompted the proposed fiduciary statute. The same impulse that moved the Delaware legislature to respond to Van

\textsuperscript{116} But see Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981)(independent directors appointed to determine whether derivative action against corporation's directors and officers might be influenced by "'there but for the grace of God go I' empathy').

\textsuperscript{117} But see Fliegler v. Lawrence, 361 A.2d 218, 221 (Del. 1976)(ratification by majority of shares held by interested directors does not change burden of proof to demonstrate fairness in transaction involving interested directors). One obvious solution to the problem of shareholder bias would be to require approval by a majority of the disinterested shareholders. See American Law Institute, \textit{Principles of Corporate Governance: Analysis and Recommendations}, \textsection 5.02(a)(2)(c)(Proposed Final Draft, 1992). See generally Marleen A. O'Connor, \textit{How Should We Talk About Fiduciary Duty? Directors' Conflict-of-Interest Transactions and the American Law Institute's Principles of Corporate Governance}, 61 G. W. L. Rev. 954 (1993)(examining treatment by Section 5.02 of directors' duty of loyalty in conflict-of-interest transactions). However, since Delaware is highly unlikely to adopt such a requirement, and other states could not impose it on Delaware corporations, this solution does not appear to be practically available.


\textsuperscript{120} See generally ROBERT C. CLARK, CORPORATE LAW 141-262 (1986).
Gorkom with section 102(b)(7) makes it unlikely that the state would otherwise broaden directors' accountability.

Finally, the normal remedies for violation of the duty of loyalty further underscore the limitations of exclusive reliance on that duty to protect shareholder interests. Traditionally, courts have held directors accountable only to the extent that they have benefited from their self-dealing. Thus, if a director is unfairly enriched by a transaction implicating his personal interest, then either the transaction must be rescinded or the director must reimburse the corporation for the difference between the contract price and a fair price. By contrast, a director's liability for breach of her duty of due care is measured strictly by the damages caused by her violation, regardless of whether she realized any gain by her conduct. Obviously, then, the sanctions available for violation of the duty of loyalty carry considerably less deterrence than those imposed for lack of due care.

3. The Utility of Due Care

Of course, the limitations on the duty of loyalty as a device for fostering responsible conduct do not establish that enforcement of the duty of care will accomplish that purpose either. Still, the cases in which directors have been found to have acted negligently underscore the need for means to hold directors accountable even where self-dealing has not been present or at least demonstrated. By countering through outreach the permissiveness of statutes like Delaware's section 102(b)(7), clarifying the presumptive components of due care, and candidly recognizing a substantive dimension to directors' negligence, the proposed fiduciary statute would attempt to restore and improve the effectiveness of the duty of due care.

a. Acknowledging the Existence of Negligence

Fear of prohibitive insurance rates for directors apparently stymied state legislatures into their adoption of various versions of sec-


124. See infra notes 133-69 and accompanying text.

125. See infra notes 182-224 and accompanying text.
tion 102(b)(7). This reason alone, however, does not seem a sufficient justification for virtually eviscerating the duty of due care. After all, skyrocketing physicians' insurance costs have not driven states to allow doctors to immunize themselves from malpractice claims. At some level, these statutes embody two types of skepticism. The first type reflects a retrenchment of the traditional interventionist role that state-formulated rules have played in regulating corporate relationships; this resistance to mandatory rules arises out of contractual theory and will be addressed later. The second type of skepticism amounts to a repudiation of the Van Gorkom decision, for section 102(b)(7) effectively overturns the holding in that case. If the statute had been in effect at the time of the Trans Union merger, the shareholders could not have recovered for their losses resulting from the directors' negligence. This reversal seems to represent not only disagreement with the specific outcome in Van Gorkom, but also a broader lack of faith in the ability of courts to provide effective remedy for directors' failure to exercise adequate care. Yet, the circumstances of Van Gorkom and other decisions finding a lack of due care do not support the contention that courts have lightly

126. See Stern, supra note 1, at 3-4. Of course, competition for corporate charters no doubt also played a significant role in the usual “race to the bottom.” See William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663, 665 (1974). However, while keeping up (or down) with Delaware may have formed much of the immediate stimulus to adopting 102(b)(7)'s counterparts, Delaware in turn was ostensibly responding to the specter of spiraling insurance rates raised by Van Gorkom.

127. For the view that severe limitations imposed on directors' liability represented an overreaction to Van Gorkom, see Hazen, supra note 71, at 179-80; Thomas C. Lee, Note, Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and The Erosion of the Directors' Duty of Due Care, 136 U. PA. L. REV. 239 (1987).


130. See infra Part III.


132. Since section 102(b)(7) is not self-executing, this conclusion assumes that Trans Union's charter would have contained a provision shielding directors from liability to the full extent permitted by the statute. In light of common practice, see DELAWARE CORPORATION LAW AND PRACTICE § 6.02(7)(1992)(widespread adoption of implementing charter amendments); 1 Corporate Counsel Weekly (BNA) No. 48, at 1 (1987), there seems no reason to assume that Trans Union would not have elected to have such a provision.
or irresponsibility determined that actionable negligence has occurred.

Too much has already been written about *Van Gorkom*\(^{133}\) to warrant rehashing in comprehensive detail the sequence of events there. To support the proposed statute, which seeks to revive meaningful judicial enforcement of the duty of care, it seems sufficient to demonstrate that the *Van Gorkom* court's holding that Trans Union's directors breached that duty is eminently defensible. The court's compendious account of the facts reveals that the directors' lapses amounted to far more than a mere mistake in judgment. As the court summarized its reasons for concluding that the board's decision to sell the company for $55 per share could not be considered an exercise of informed business judgment:

The directors (1) did not adequately inform themselves as to Van Gorkom's role in forcing the "sale" of the Company and in establishing the per share purchase price; (2) were uninformed as to the intrinsic value of the Company; and (3) given these circumstances, at a minimum, were grossly negligent in approving the "sale" of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.\(^{134}\)

The court's summary highlights the unnecessary haste that pervaded the entire transaction. The meeting in which the court approved the cash-out merger took place just two days after Van Gorkom had reached agreement with Jay Pritzker on the proposed merger and one day after notice of the meeting (but not its purpose) had been given.\(^{135}\) In approving the sale of the company, the Trans Union board relied largely upon a twenty-minute oral presentation by Van Gorkom describing the background and terms of the proposed merger.\(^{136}\) While the company's chief financial officer volunteered his opinion that $55 per share lay "at the beginning of the range" of a fair price,\(^ {137}\) no formal valuation study was presented or solicited.\(^ {138}\) None of the directors, including Van Gorkom, actually read the merger agreement before it was signed and then delivered to Pritzker


\(^{134}\) Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985).

\(^{135}\) *Id.* at 867.

\(^{136}\) *Id.* at 868-69.

\(^{137}\) *Id.* at 868.

\(^{138}\) *Id.* at 868-69, 876.
hours later. 139

The court's careful analysis also refutes the notion that extenuating circumstances account for what must otherwise be considered negligent conduct. Admittedly, the board was laboring under a tight deadline imposed by Pritzker. 140 However, even assuming that the deadline was inflexible, 141 this constraint does not excuse the directors' failure to press for more adequate information in the time that was available to them. For example, the deadline did not preclude directors from asking the company's chief financial officer, who was present at the meeting, how he had arrived at his conclusion that $55 per share represented a minimum fair price. 142 Nor were the directors barred from questioning Van Gorkom as to the basis of his own assertion that $55 constituted a fair price. 143

Similarly, the court rejected the directors' contention that the post-September 20 "market test" cured any risk that the unsubstantiated $55 figure was too low; under this rationale, the opportunity for competing offers during the ninety-day period of the test would independently determine whether the company could fetch a higher price. 144 Whatever the merit of this theory, it was undermined by the realities of the putative "test." To begin with, the evidence that the original agreement had actually authorized competitive proposals was sketchy at best. 145 Indeed, the agreement explicitly prohibited Trans Union from soliciting offers and from providing to interested parties information that was not already in the public domain. 146 Moreover, the press release announcing the agreement did not signal to the financial community that the company was up for auction. 147 Under these circumstances, the court was entitled to find that the market test served as a meager substitute for a more thoroughgoing examination of fairness.

Decisions since Van Gorkom finding lack of due care have further belied any contention that serious negligence on the part of directors

139. Id. at 869.
140. Pritzker had insisted that the board act on the merger proposal no later than Sunday, September 21, which was one day after the board had convened to consider the proposal. Id. at 867.
141. The board did not consider seeking an extension of the deadline. Id. at 877.
142. See id.
143. See id. Such inquiry would presumably have disclosed that Van Gorkom had chosen the figure on his own, without consulting financial analysts or other directors, and that most of the company's Senior Management Group had strongly opposed the $55 price as inadequate. See id. at 867, 877 n.19.
144. Id. at 878.
145. See id. at 878-79.
146. Id. at 878.
147. The release stated that Trans Union had entered into "definitive agreements" with the Pritzkers, and made no mention of the company's right to receive and accept higher offers. Id. at 879.
is a nonexistent or inconsequential phenomenon. For example, in *Sealy Mattress Company of New Jersey v. Sealy, Inc.*, Sealy's directors approved a merger at a fifteen-to-thirty minute board meeting that included five other important agenda items. In "uncritically accept[ing]" the proposed merger price, the directors did not review or seek documentation to support the fairness of the merger's terms. Among the matters about which the directors "made no effort to inform themselves of the material facts" were antitrust judgments against Sealy whose true value was a "critical factor in any assessment of the fairness of the merger price." Likewise, other offers and valuations placing the value of Sealy higher than that reflected by the merger price did not enter into the board's calculations. Nor did the board seek the advice of any outside attorney or investment banker. The defendants did cite their position as employees of either Sealy's parent, Ohio-Sealy, or Ohio-Sealy's parent as justification for acquiescing in the transaction proposed by Sealy. The court, however, held that their separate status as directors of Sealy required that they independently inform themselves with a view toward protecting the interests of all of Sealy's shareholders, including the minority.

Other cases similarly evidence some board's susceptibility to inexcusably sloppy procedures involving fundamental decisions. In *Edelman v. Fruehauf Corp.*, Fruehauf's board approved an offer for control of the corporation for apparently less value than other suitors were prepared to offer and less than would be warranted by the valuation of the company's investment advisor. The Sixth Circuit Court of Appeals found that the wholesale deference by a special committee of outside directors to the opinions of management amounted to an abdication of the directors' fiduciary duty to conduct an independent review and exercise independent judgment. As in *Van Gorkom*, at

148. For a survey of decisions through the end of 1987 finding a lack of due care, see Radin, *supra* note 75, at 728-44.


150. *Id.* at 96,678.

151. *Id.* at 96,683.

152. *Id.* at 96,677.

153. *Id.* at 96,683.

154. *Id.* at 96,677.

155. *Id.* at 96,677, 96,683.

156. *Id.* at 683.

157. *Id.*


160. The Sixth Circuit upheld the district court's finding on this point. *Id.* at 1540.
no time during the brief period\footnote{161} that the directors met to discuss the proposed transaction did they mount a serious effort to determine the actual value of the company.\footnote{162} Similarly, in \textit{Hanson Trust PLC v. ML SCM Acquisition, Inc.},\footnote{163} SCM's board approved an asset lock-up option at a three-hour meeting without exploring whether the option price represented the fair value of the two businesses being offered.\footnote{164} The board did not request an opinion of the range of fair value from the investment banker that it had retained\footnote{165} (the firm in fact had not calculated such values); nor did the directors discuss the impact on SCM of selling two businesses representing about half of the company's income.\footnote{166} The Second Circuit Court of Appeals found that these omissions, under circumstances indicating no "emergency need for a hasty decision . . . strongly suggest[ed]" a violation of the duty of due care.\footnote{167} While Hanson, the optionee's rival in the contest for control of SCM, had not demonstrated a breach on the order of the Trans Union board's gross negligence in \textit{Van Gorkom},\footnote{168} the court held that Hanson was entitled to a preliminary injunction against the exercise of the challenged lock-up option.\footnote{169}

The above list could be extended,\footnote{170} but even this brief catalogue raises deep doubts that judicial vigilance against directors' negligence could be discarded at little or no cost. Of course, one must respond to the argument that the post-\textit{Van Gorkom} cases prove the opposite: that shareholders do not require the ability to sue for personal damages to have effective recourse against directors' negligence. After all, cases like \textit{Hanson} have been resolved by injunctive relief, which a certificate of incorporation cannot bar under section 102(b)(7).\footnote{171} However,
the elimination of personal damages seems patently unfair and underdeterrent. The possibility or even probability that a harm can be averted or ameliorated is generally thought to complement, not supplant, the remedy of damages on those occasions when preventive mechanisms have failed. So embedded even in corporate law is the principle that rights imply remedies that damage remedies have been assumed to reside in securities laws that make no explicit mention of them.172 When breach of due care by directors involves hasty action and sketchy information, there is no assurance that affected shareholders will be able to detect the negligence in time to take effective action. When the board's proposal becomes a fait accompli, plaintiffs then face many courts' pronounced reluctance to undo a consummated transaction.173 Moreover, since injunctive relief does not adversely affect the position of individual directors, it obviously possesses little if any of the deterrence value of personal damages.174

b. The Practicality of Specifications

Even granting that legitimate shareholders' remedies should not be unduly restricted, one might still object to the proposed statute's effort to reduce the concept of negligence to detailed criteria. This concern should be somewhat mitigated by the statute's intent to consider the presence or absence of particular procedures as factors to be weighed, not as inflexible demands straitjacketing director's discretion.175 Directors would always remain able to demonstrate that departure from a prescribed step comport with the fundamental requirement of due care.176 Moreover, courts regularly extract specific guidelines177 and even rigid rules178 from general statutory dire-


173. See Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386 (1970)(nothing in policy of section 14(a) "requires the court to unscramble a corporate transaction merely because a violation occurred") (citation omitted); Yamamoto v. Omiya, 564 F.2d 1319, 1324 (9th Cir. 1977); Swanson v. American Consumers Indus., Inc., 475 F.2d 516 (7th Cir. 1973); Del Noce v. Delyar Corp. 72 CIV. 1819-CLB, 1976 WL 813 (D.C.N.Y. July 30, 1976).


175. See Stern, supra note 1, at 8-9.


177. See, e.g., Alexander v. Choate, 469 U.S. 287 (1985)(construing section 504 of Reha-
tives; the proposed fiduciary statute would simply spell out the relevant considerations rather than leave these to judicial inference. Indeed, statutory specification would remove much of the vagueness inherent in the traditional totality-of-the-circumstances approach toward negligence and thus reduce rather than increase the chill cast on directors' decisionmaking by application of the duty of due care.

Still, it might fairly be questioned whether the benefit derived from prodding boards to adopt more thorough procedures can justify the intrusive nature of an outreach statute. At one level, this is simply an empirical question that can only be resolved by experience gained through enactment of such legislation. If this type of statute proved counterproductive, it could always be rescinded by the enacting state or else overridden by federal action. It does not seem convincing to argue, however, that adherence to the type of procedures proposed here would inevitably fail to improve the quality of board decisionmaking. On the contrary, in the absence of empirical evidence, it seems intuitively difficult not to believe that more thorough deliberation would have produced better decisions than at least some of those that courts have held to be the product of negligence. For example, one does not readily envision Trans Union's directors—assuming genuine devotion to the interests of the company's shareholders—accepting Pritzker's offer had they insisted on a plausible valuation of the company or even made sufficient inquiry to learn the dubious origin of the $55 figure.

Similarly, one would not expect Fruehauf's directors, assuming good faith, to have accepted a bid worth less than both alternative offers and a reliable valuation of the company if they had taken the trouble to learn about either of these two pieces of information.

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179. See infra notes 195-223 and accompanying text.

180. The inadequacy of the $55 figure is suggested by an offer, made several months after the meeting at which the board voted to accept Pritzker's offer, to purchase all of Trans Union's assets and to assume all of its liabilities, for the equivalent of $60. Smith v. Van Gorkom, 488 A.2d 858, 884 (Del. 1985). The offer ultimately fell through under somewhat confused circumstances. See id. at 884-885.

181. Van Gorkom broached the figure to Pritzker, having calculated it by himself "subjectively," id. at 877 n.19, solely for the purpose of determining the feasibility of a leveraged buy-out. Id. at 866, 877.
A significant objection to the proposed statute is that there are not any prescribed procedures that can divert directors bent on acting in a particular manner. Decisions that insufficiently protect the interests of at least a segment of shareholders may result not so much from directors' failure to deliberate and apprise themselves adequately, but from lack of zeal to safeguard those interests. To the extent that suspicion of impure motive forms the real basis of the shareholders' complaint, then arguably they should be confined to an action for breach of the duty of loyalty. Such claims are neither covered by the proposed fiduciary statute nor barred by section 102(b)(7).\textsuperscript{182}

However, as discussed earlier,\textsuperscript{183} the duty of loyalty provides at best a limited means of ferreting out directors' self-interested behavior and the unfairness that it produces. Realistically, then, it is the orthodox conception of due care, not loyalty, that would have to be extended to monitor the full range of directors' inappropriate conduct. More bluntly, the proposed statute should acknowledge that it is not confined to the purely procedural concerns conventionally associated with due care. An egregiously harmful decision should not be absolutely immunized by the appearance of procedural regularity. Rather, the statute should forthrightly recognize that the criterion of reasonableness in typical formulations of directors' due care\textsuperscript{184} includes at least some substantive judgment as to the quality of directors' decisions.\textsuperscript{185}

On the surface, any inquiry into substantive fairness might appear to be at odds with the proposed statute's exclusion of questions of loyalty. In fact, however, substantive assessment of a board's decision complements the statute's overriding emphasis on the process by which that decision was reached. The statute is designed to ensure that directors base major decisions upon ample information and thorough deliberation. Where board decisionmaking superficially meets these requirements, but still produces a result that manifestly works against shareholders' interests, it does not strain the core conception.


\textsuperscript{183} See supra notes 87-123 and accompanying text.


\textsuperscript{185} One instance where courts already clearly pass such judgment is in their review of defensive tactics designed to thwart takeovers. Poison pills have been overturned where courts have determined that the only reason for the measure was to simply to stop the raider. E.g., Southdown, Inc. v. Moore McCormack Resources, Inc., 686 F. Supp. 595 (S.D. Tex. 1988); Grand Metropolitan Pub. Ltd. Co. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assoc. Ltd., Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).
of due care to pronounce the directors negligent. For example, if a board were to decline an offer for the company at $50 per share, in favor of another offer at $45 per share, then absent compelling circumstances a court could hold that the directors did not act "with such care . . . as an ordinarily prudent person in a like position would use under similar circumstances."\(^{186}\) In that instance, the real reason for the directors' action might well be the presence of an agenda other than the interests of the prejudiced shareholders, but one that does not fall under any of the formal headings of self-dealing. Whether the court suspected improper motivation or not, it would be entitled to judge the conduct as failing to display the "skill and diligence"\(^{187}\) expected of a prudent director genuinely devoted to the welfare of the corporation and all of its shareholders. Again, such a result would not render the proposed statute's procedural guidelines superfluous. On the contrary, the statute is intended to place before the directors all of the information pertinent to their decision. If they reach a decision that flies in the face of the obvious import of that information, then a court enforces a fundamental aspect of due care when it pronounces them negligent.

Although perhaps a departure from orthodox understandings of the duty of care, the inclusion of substantive review would not represent a radical break from the actual manner in which courts apply negligence doctrine. Rather, open consideration of substantive matters would bring to light a determination that courts have often tacitly made under the auspices of procedural analysis. Indeed, the premise that the board's ultimate decision was substantively flawed is implicit in almost any holding that directors have acted negligently. For example, when the target corporation's board in \textit{Buckhorn, Inc. v. Ropak Corp.},\(^{188}\) erected defenses to fend off Ropak's tender offer, the court's ruling that the poison pill was not a reasonable response to the offer\(^{189}\) reflected on the wisdom of the decision itself as well as the board's mode of arriving at it. The court's conclusion that the directors did not show that they had exercised due care\(^{190}\) did center around their failure to inquire into information "relevant to the assessment of the reasonableness of the prices set in the poison pill,"\(^{191}\) thus grounding the analysis in due care's typical focus on procedural shortcomings. In effect, though, the court was also rendering a judgment that the board's valuation of Buckhorn's stock was presumptively exaggerated,\(^{192}\) that the directors had apparently harmed Buckhorn share-

\(^{186}\) CAL. CORP. CODE 309(a)(West 1990).
\(^{188}\) 656 F. Supp. 209 (S.D. Ohio), aff'd mem., 815 F.2d 76 (6th Cir. 1987).
\(^{189}\) \textit{Id}. at 235.
\(^{190}\) \textit{Id}. at 231.
\(^{191}\) \textit{Id}.
\(^{192}\) See \textit{id}. at 230-31.
holders by purchasing their shares on the open market, and that stock options awarded to some members of Buckhorn’s management did not benefit the corporation. 

Buckhorn also illustrates how the theoretical dichotomy between due care and loyalty concerns blurs in practice. While upholding some provisions of the “golden parachutes” approved by the Ropak board, the court enjoined the board’s grant of new stock options to key managerial employees as well as its decision to permit acceleration of the chief executive officer’s salary and pension if control of the corporation changed hands and the decision to extend his employment agreement by six years. The court found that none of these qualified as “reasonable measures in relation to the threat posed.”

Although framed as questions of due care, these determinations were obviously colored by loyalty’s apprehension that the directors’ actions were infected by self-interest. Indeed, even the Delaware Supreme Court has recognized that “the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders,” warrants a more skeptical version of the business judgment rule when assessing the validity of defensive measures.

In the case of golden parachutes, of course, the potential for personal aggrandizement is highly visible. In other instances, concerns about various forms of self-interest have contributed more obliquely to nullification of board action under the rubric of lack of due care. These cases suggest that restoring the effective reach of due care, as the proposed statute would attempt, would redress more than mere sloppiness. For example, as Dean Clark has pointed out, the prominent negligence case of Litwin v. Allen in reality involved more than the failure of directors of the Guaranty Trust Company to display adequate skill and diligence. The directors were found liable for approving the purchase of convertible debentures where the seller retained a six-month option to repurchase the debentures at the same price that the Trust Company had paid. Liability was based on the court’s determination that the arrangement was “so improvident, so risky, so unusual and unnecessary as to be contrary to fundamental

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193. See id. at 232.
194. See id. at 216-17, 232-33, 237.
195. Id. at 232-35, 237.
196. Id. at 233, 237. The court also enjoined amendments to existing stock options that would have allowed vesting upon change of control. Id. at 233.
197. Id. at 235, 237.
198. Id. at 233; id. at 235.
199. Unocal Corp. v. Mesa Petroleum Corp. 493 A.2d 946, 954 (Del. 1985).
200. See id. at 955.
201. See CLARK, supra note 120, at 127-28.
conceptions of prudent banking practice.”203 The court’s own account, however, failed to demonstrate convincingly that the degree of risk involved fell outside the protection of the business judgment rule.204 Rather, the result is better explained as an objection to the directors’ decision to let the Trust Company absorb the risk in order to avert a substantial financial setback to the corporation that controlled the Trust Company.205 Hence, the true defect in the transaction was the Trust Company directors’ suspected lack of loyalty. However, the available evidence could not establish that the directors had been improperly influenced or dominated or had acted in bad faith or in pursuit of personal gain.206 Faced with conduct that seemed clearly to violate directors’ basic fiduciary obligations, but which did not fall neatly into either of the principal categories of breaches as traditionally conceived, the court apparently chose breach of due care as the catchall designation for fundamentally unacceptable but doctrinally elusive behavior.

Other decisions finding negligence by directors also reflect converging due care and loyalty concerns rather than an exclusive preoccupation with procedural propriety. In Sealy Mattress, as in Litwin, the inadequate care shown by directors could be largely attributed to the greater attention given by the board to the interests of the parent corporation, rather than to the interests of the subsidiary on whose board they sat. The Sealy directors themselves conceded their lack of independence, stating that they had “[functioned] in a ministerial capacity to carry out the parent [corporation’s] bidding.”207 Similarly, the “aura of inevitability”208 that surrounded the Frantz board’s hasty decision to transfer treasury shares to the company’s ESOP could be readily explained by the obvious purpose of the move: to overturn EAC’s takeover of the company by diluting the majority control that EAC had just obtained.209 In Hanson, the presence of a “self-interested management proposing a defensive LBO”210 appeared to increase the court’s inclination to conclude that the SCM board’s inadequate deliberations leading to approval of the asset lock-up option displayed a lack of due care.211 Fruehauf, too, illustrates the

203. Id. at 699.
204. See id. at 691-99; CLARK, supra note 120, at 127.
205. See CLARK, supra note 120, at 127-28.
209. See id. at 620.
211. Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 277 (2d Cir. 1986). See also Freedman v. Restaurant Associates Indus., Inc., [1990 Transfer Binder]
sharpened focus that due care scrutiny takes in the context of a management leveraged buyout. The trial court's holding that Fruehauf's directors breached their duty of care is laced with considerations of loyalty: the directors' negligence lay in their failure to review thoroughly and dispassionately "management's proposed self-interested transaction" and in their acquiescence of the use of company assets to "facilitate management's self-dealing and unfair auction."\footnote{212}

Even \textit{Van Gorkom}, generally regarded as purely involving a breach of due care,\footnote{213} hints of the court's unwillingness to ascribe the behavior of Trans Union's directors merely to well-intentioned ineptitude. While the court noted the absence of any allegations or proof of fraud, bad faith or self-dealing,\footnote{214} the opinion casts the directors' motivation and character in a light that can hardly be considered benign. The court's description of the proxy statements soliciting shareholder approval of the merger paints a picture of guile and deceit: the directors "cloaked" the absence of crucial information through "artful drafting" and misled the shareholders through "false and misleading" shadings of key matters.\footnote{215} Indeed, the court appears repeatedly to question the veracity of the directors in rejecting their account of events. Responding to the directors' seeming contention that a contractual provision for a "market test" excused their failure to assess fairness in other ways, the court averred that the directors had "no rational basis" for thinking that such a test was authorized.\footnote{216} The directors' assertion that they had "insisted" upon two amendments permitting a market test was met with similar disbelief.\footnote{217}

\footnote{212} Plaza Securities Co. v. Freuhauf Corp., 643 F. Supp. 535, 1543 (E.D. Mich. 1986). \textit{See also} Kumar v. Racing Corp. of America, Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) \# 95,896, at 99423 (Del. Ch. 1991)(finding that the "almost ... perfunctory" board meeting at which merger was approved indicated likelihood of breach of duty of due care, where court also found that timing of merger constituted unfair dealing).

\footnote{213} \textit{See Deborah A. Demott, Directors' Duties in Management Buyouts and Leveraged Capitalizations, 49 OHIO ST. L.J. 517, 544 (1988)(negligence found in \textit{Van Gorkom} "uncompounded by self-dealing or evident self-interest in any form").}

\footnote{214} Smith v. Van Gorkom 488 A.2d 858, 873 (Del. 1985). \textit{See id.} at 889 (indicating assumption that Trans Union directors acted in good faith).

\footnote{215} \textit{Id.} at 890-91.

\footnote{216} \textit{Id.} at 878. The court also showed little tolerance for the directors' professed reliance on putative terms of the original merger agreement. The directors never produced the agreement, and the court found "[n]o acceptable explanation" for their failure to do so. \textit{Id.}

\footnote{217} \textit{See id.} at 879-80.
directors' version of their counsel's advice at the meeting is called into question, viewed in the context of directors' claims "made months and years later, in an effort to extricate themselves from liability."218 The perspective displayed by these passages is especially striking in an appellate opinion; not only was the court not acting as an original factfinder but it also had to find the trial court's contrary perceptions clearly erroneous in order to reach its conclusion.219

On the subtle fault line between due care and loyalty, one can also detect suggestions of doubt about Van Gorkom's own devotion to the best interests of Trans Union's shareholders. The opinion at least permits the inference that Van Gorkom's conduct was prompted by a personal agenda. Since Van Gorkom was not unsophisticated about either business or finance,220 it might readily be suspected that the imminence of his retirement and his social acquaintance with Pritzker221 had more to do with his headlong plunge into the dubious agreement than a failure to consider the disadvantages of its terms. Such sources of motivation may not represent typical self-dealing, but they represent a type of self-interest nonetheless. Because the record precluded an express attack on Van Gorkom's loyalty, however, the court instead launched an indirect attack through its implied skepticism of Van Gorkom's proffered explanation for his behavior, especially his discouragement of competing offers.222 Van Gorkom in a sense illustrates how the requirements of due care, taking seriously the question of how a responsible director would act, can reach conduct whose indicia of unfairness do not meet the often stringent223 demands of proof for violation of the duty of loyalty.

Of course, considerations of unfairness should always play a subordinate role in the examination of claims that directors have breached their duty of care. An inordinate emphasis on unfair terms and unfair dealing would undermine key justifications for the type of outreach statute proposed here: Courts possess peculiar expertise to assess procedural adequacy, procedure-oriented standards give direc-

218. Id. at 880-81.
219. See id. at 864.
220. See id. at 894 (McNeilly, J., dissenting).
221. Id. at 866.
222. For example, the court noted that while Van Gorkom professed to base his "completely negative" reaction to a competing offer by Kohlberg, Kravis, Roberts & Co. ("KKR") on its financing condition, Pritzker's offer had been similarly conditioned and was still accepted expeditiously. Id. at 884-85. In addition, when KKR withdrew its offer, it cited the "sudden decision" by the Chief Officer of a Trans Union operation to withdraw from the KKR purchasing group. Although Van Gorkom had recently spoken to that officer about his participation in the KKR purchasing group, he "denied any responsibility for the officer's change of mind." Id. at 885. The opinion's bland recitation of Van Gorkom's denial leaves the strong impression that the court does not believe it.
223. See CLARK, supra note 120, at 126.
tors reasonable notice of expected conduct, and enforcement of the duty of care does not usurp the prerogative of the state of incorporation to shape the duty of loyalty. However, as the cases discussed above indicate, such considerations already subtly enter into determinations of due care. The statute, or perhaps just the jurisprudence flowing from it, could simply make this analysis more explicit. Also, as part of the safe harbor rationale for statutory specification of presumptive procedures, judicial review of fairness should occur on a sliding scale: The more that a board decision conforms to procedural norms, the less susceptible to substantive scrutiny it should be.

Finally, even if the proposed statute were confined to procedural matters in a strict sense, it would still fill a significant void in the current regime for enforcement of fiduciary duties. Van Gorkom and other cases demonstrate that the phenomenon of negligent behavior by directors, whatever its motivation, is neither nonexistent nor innocuous. Section 102(b)(7) and its counterparts virtually invite directors to slight the importance of due care. Certainly, other states may believe that the availability of injunctive relief does not constitute a potent incentive for directors to display the skill and diligence that shareholders have the right to expect of them. These states should be entitled to effectuate that belief through legislation that safeguards the interests of their resident shareholders.

III. REJECTING THE CONTRACT MODEL

The incompatibility of the proposed outreach statute with the contract model of the corporation was noted in the earlier article proposing adoption of the statute. Again, contractarians would undoubtedly view the statute as wrongly disregardful of the shareholders' agreement to govern directors' conduct by the more permissive regime of the state of incorporation. More broadly, since contractarians characterize the corporation as essentially a nexus of contracts, they generally endorse the prerogative of shareholders to determine by compact the rules under which corporate relationships shall be conducted. This section does not undertake a full-scale cri-

224. See Stern, supra note 1, at 8 n.28 and accompanying text.
225. Stern, supra note 1, at 3-5.
227. For rationales of the right to "opt out" of corporate rules prescribed by the state
tique of the premises and utility of the contract model. Rather, it points to considerations that might persuade a state to adopt the proposed fiduciary statute over objections grounded in contractual freedom.

A. Countervailing Values

The contract model embodies both an economic theory and a system of values. As a matter of analysis, contractarians believe that market forces will produce rules of governance more efficient than those imposed by government. They assert that the necessity of retaining investors will compel even highly self-interested and formally unrestrained managers to act in ways that benefit shareholders. Similar logic dismisses condemnation of competition among states for corporate charters. Seen through contractarian lens, the "race to the bottom" actually amounts to states' healthy effort to develop rules that are most attractive to profit-maximizing managers (and hence most conducive to the welfare of shareholders).

Philosophically, the contract model is rooted in notions of individual and associational autonomy. Individuals should generally be left free to pursue their own interest, and to band together on such terms as they choose for the purpose of maximizing their wealth. Acknowledging no independent obligation to place the welfare of others ahead of one's own, contractarians tacitly disavow the "communitar-
ian ethic" of traditional fiduciary law. That ethic empowers the state to enforce the fiduciary's responsibility never to act for purely self-seeking ends.

It is not necessary to refute the economic case for contractual freedom in corporate law in order to reject the laissez-faire regime to which it leads. A state might well conclude that the potential (and speculative) economic benefits of a nonmandatory approach to fiduciary rules are not worth the harm tolerated by that approach in individual instances. The moral imperative of holding directors to a high standard of responsibility, in and of itself, could justify shielding shareholders from the consequences of careless board behavior. Fiduciary law has never sought validation in a particular set of economic assumptions. Instead, the fiduciary's obligation to consider the beneficiary's interest paramount has been regarded as a sufficient good, not simply the means to fulfillment of a larger economic design. Policies that protect shareholders may therefore be understood and upheld as "rights-based" rather than "utilitarian."

Thus, the proposed fiduciary statute would continue a tradition that refuses to sacrifice ethical obligation on the altar of economic theory. Though novel in its reach, the statute simply extends the principle represented by blue sky laws and by the regulation of "pseudo-foreign" corporations. Companies may not rely on foreign incorporation to evade state policies designed to protect resident investors. Moreover, this type of statute might test whether the popularity of nonmandatory rules truly reflects the persuasiveness of contract ideas.

234. See Pepper v. Litton, 308 U.S. 295, 311 (1939) (fiduciary's power "may not be exercised for the aggrindisement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis"); Guth v. Loft, 5 A.2d 503, 510 (Del. 1939) (holding that fiduciaries "are not permitted to use their portion of trust and confidence to further their private interests"); Bayer v. Beran, 49 N.Y.S.2d 2, 5 (1944) (fiduciary "must subordinate his individual and private interests to his duty to the corporation whenever the two conflict").
235. See infra notes 267-73 and accompanying text.
236. This is particularly true if each such instance is a case where there is an obvious payoff for short-term violation of the contractual norm, such as where the company is being sold to others. In other words, the utility and benefits of promise-keeping in general, in the long run, cannot sustain an argument where the context limits horizons to the short-run.
239. See Stern, supra note 1, at 70-71.
240. See Stern, supra note 1, at 67.
or instead simply results from the current futility of attempting to impose mandatory rules.241

Nor would the moral priority of the proposed statute constitute a radical departure from well-established legislative practice. Many common regulations forego potential economic efficiency in order to vindicate other values. For example, it might be cheaper (at least to the present generation, presumably a legitimate perspective in the self-seeking scheme of contractarians) to ignore long-term environmental degradation, but society addresses this danger out of concern for the quality of life of its descendants. Similarly, while the elaborate machinery of antidiscrimination laws may make both business and government more expensive,242 the inherent invidiousness of discrimination justifies these economic burdens.

In response to these analogies, it could be argued that these and other243 examples pit economic costs against incommensurable nonpecuniary harms, whereas the contract model offers financial gain to the very shareholders that fiduciary law purports to protect. However, even regulation that appears to be purely economic in nature is often designed to achieve other goals as well. The antitrust laws provide one such instance. It is by no means clear that the Sherman Act's244 insistence on competition245 invariably produces optimal economic outcomes.246 Nevertheless, the policy remains intact in part because the Sherman Act was animated by an aversion to excessive concentration of power transcending any particular economic theory.247

B. The Decline of Contract

While the above discussion generously assumes the power of con-

241. Companies may currently escape a mandatory rule simply by reincorporating another state that does not impose the rule.


243. For example, a market solution to dangerously flawed products—relying upon consumers' rejection to remove them from the marketplace—might entail less expense than the law of products liability. Likewise, family matters such as adoption might be deregulated and left to private financial arrangements. See RICHARD A. POSNER, SEX AND REASON 409-17 (1992)(proposing free market system for the sale of parental rights over babies, including elimination of price ceiling on payment to biological mother to surrender her parental rights over her baby).


tract analysis, the contractarian prescription for corporate governance has hardly gone unchallenged. Even at the level of description, the contract metaphor has been faulted for mischaracterizing the dynamics of corporate governance. Certainly, a state's adoption of the proposed fiduciary statute should not be barred by any illusions about the infallibility of the contract model.

In placing the current debate in perspective, it is perhaps worth noting that the larger concept of contractual freedom has suffered considerable decline from its zenith early in this century when *Lochner* enshrined "liberty of contract" in the due process clause of the Constitution. Though it may be an exaggeration to pronounce the death of contract, faith in the efficacy of unchecked "voluntary" economic bonds has undoubtedly diminished, as illustrated by the disrepute into which *Lochner* itself has fallen. Interestingly, the contract model of corporate governance resembles in a number of ways the largely discredited conception of contract law inspired by Langdell. Just as the orthodox general theory of contract purported to be scientific in character, so contractarians pride themselves on the asserted empirical rigor of their ideas. As a corollary, both systems also base their legitimacy on dubious claims of neutrality and objectivity. The pretense that the classical theory of contract derived from discovered principles—as opposed to scholars' and judges' creativity—was exploded long ago. In constitutional law, the Lochneresque liberty of contract is widely regarded as a product of the justices' eco-

248. See supra note 228.


251. Id. at 53.


254. See GILMORE, supra note 252, at 12-15.

255. Id. at 12.


257. See GILMORE, supra note 252, at 5-53.
nomic biases rather than a neutral tenet of the due process clause.\textsuperscript{258} While the contract model in corporate law by contrast enjoys substantial credibility, the contractarians' program nevertheless has been shown to be decisively shaped by the values that they hold.\textsuperscript{259}

In addition, the \textit{Lochner} Court's apotheosis of contractual liberty and contemporary champions of a laissez-faire approach to corporate governance both assume a type of consent bearing a tenuous connection to real-world conditions. The bakers in \textit{Lochner} were presumed to freely bargain to work the long hours that New York sought to limit in the legislation struck down by the Court;\textsuperscript{260} the Court ignored the practical coercion that compelled these workers to accept such terms.\textsuperscript{261} In the contractarian paradigm, shareholders are also portrayed as having voluntarily consented to whatever license is granted to directors' behavior by the corporate charter.\textsuperscript{262} In reality, however, shareholders of larger corporations cannot commonly be said to bargain meaningfully over the content of charter provisions holding directors harmless for sloppy behavior; "only rarely would shareholders know its content and even more rarely would they negotiate with the director about that content."\textsuperscript{263}

Finally, both the \textit{Lochner} era and the modern contractarians illustrate the danger of elevating a helpful insight into absolutist dogma. For years the Supreme Court, striking down progressive legislation addressed to relationships of unequal power,\textsuperscript{264} distorted the valid premise that our economic system depends mostly on free bargaining. Today's advocates of almost unlimited contractual freedom in corporate law ignore the possibility that useful mandatory rules can exist within a generally consensual regime. Indeed, the contractarian perspective itself provides reasons for limiting the ability of corporations


\textsuperscript{261} See KENS, supra note 258, at 157.


\textsuperscript{263} DeMott, supra note 249, at 923. \textit{But cf.} G. Richard Shell, \textit{Arbitration and Corporate Governance}, 67 N.C. L. REV. 517, 550 (1989)(arguing that the likelihood that shareholders are "equally ignorant" of all provisions of a charter rules it inappropriate to invalidate a particular provision because of lack of conscious consent).

\textsuperscript{264} See, e.g., Adkins v. Children's Hospital, 261 U.S. 525 (1923)(invalidating minimum wage legislation for women on substantive due process grounds).
to opt out of such rules. 265 Fiduciary rules present a particularly compelling case for departing from the pure contract model, because shareholders cannot determine in advance precisely what conduct they will be authorizing by waiving these rules. 266 Thus, the proposed fiduciary statute, while incompatible with notions of unbounded contractual freedom, can be reconciled with a more reasoned approach to the contractual view of the corporation.

C. The Intrusion of Reality

In considering the proposed fiduciary statute, few legislators would be likely to immerse themselves in the arcana of economic theory. Rather, most would probably judge the statute's potential effectiveness by how they perceive the success of more relaxed restraints on directors' authority. Given recent abuses, that perception might well enhance receptiveness to this type of measure. Many legislators, surveying the fallout of misplaced trust in managerial discretion, might readily reject the contractarians' benign view of the likely results of directors' self-seeking.

Daily headlines of the past several years provide legislatures with abundant evidence of the danger of managerial avarice to corporations, their shareholders, and the economy itself. The massive savings and loan scandal—unleashed by a deregulatory policy not unlike the contractarians' laissez-faire prescription267—mocks the contractarian notion that managers' selfishness is inherently channeled into beneficial behavior. Similarly, huge salaries for executives of highly unprofitable corporations epitomize the potential for harm from lack of managerial accountability.268 These as well as other examples of management self-aggrandizement269 and recklessness,270 could persuade

266. See Gordon, supra note 265, at 1593-94.
269. See, e.g., BRYAN BORROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO 94-96 (1990)(describing corporation president's maintenance of large private aircraft fleet and habit of flying his dog with him around the country in a separate aircraft); Kurt Eichenwald, Changing the Culture of Spending at Merrill Lynch, N.Y. TIMES, Feb. 4, 1990, § 3, at 12.
legislatures that shareholders' well-being depends on more than the
discipline of the market.271

Perhaps contractarians' infatuation with market solutions simply
represents the most recent turn in a long-running historical cycle. Af-
fter all, faith in the efficacy of theoretically free bargaining well pre-
dates even the Lochner era. The position that private agreement
should supersede exogenous standards of fairness can be traced at
least to the first part of the nineteenth century.272 Elegant theory has
proved fallible before, and some legislatures might now prefer fiduci-
ary principles forged by long experience to the latest installment of a
recurring intellectual fad.273

D. The Incentives of the Market

It has been assumed thus far that market theories oppose most
mandatory fiduciary rules and would undoubtedly disapprove of the
outreach statute proposed here. The proposed statute, however, can
answer at least some of the reservations that contractarians raise
against government interference with market forces. For example,
some contractarians note that few corporation laws can be regarded as

270. See, e.g., Kathy M. Kristof & Victor F. Zonaan, First Capital Rose Fast, Sank
Faster, L.A. TIMES, May 11, 1991, at D1 (excessive purchase of "junk bonds"); Scot

271. Ironically, these examples suggest that the underlying logic of the Coase Theo-
rem, a pillar of contract theory, can be turned against contractual freedom. The
Coase Theorem posits the futility of legal rules that obstruct what those governed
by the rule regard as the most effective arrangement between them. Under the
theorem, parties will simply devise a means other than that forbidden by law to
attain their desired end. See JULES L. COLEMAN, MARKETS, MORALS AND THE
LAW 67-81 (1988); Glenn W. Harrison & Michael McKee, Experimental Evalua-
tion of the Coase Theorem, 28 J.L. ECON. 653 (1985); James Lindgren, "Ol' Man
River . . . He Keeps on Rollin' Along": A Reply to Donohue's Diverting the
Coasean River, 78 GEO. L.J. 577 (1990). In the corporate context, contractarians
note that managers can defeat governmental restraints on their ability to achieve
personal gain by rewarding themselves through other provisions. See Easter-
brook & Fischel, supra note 229, at 1433. However, the same ingenuity that en-
ables parties to circumvent rules thought to be inefficient can also be employed
for less noble purposes. The examples above suggest that in the real world—as
opposed to the contractarians' Ponglossian universe of managers' advancing their
fortunes solely by improving their company's position—neither legal rules, con-
tractual arrangements, nor the good of the corporation stands in the way of many
managers' drive for personal enrichment. Therefore, legislation like the pro-
posed fiduciary statute may appeal to legislatures as a way to redress inevitably
inimical behavior.

272. See MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780-1860, 209-
10 (1977).

273. See Robert C. Clark, Contracts, Elites, and Traditions in the Making of Corporate
Law, 89 COLUM. L. REV. 1703, 1726-46 (1989)(asserting that old, fundamental prin-
ciples like fiduciary duties entitled to considerable deference in face of clever
academic critiques that may lack some connection to actual experience).
effectively mandatory in light of the availability of reincorporation and offsetting charter provisions.\textsuperscript{274} Through its outreach provision, however, the proposed statute would drastically reduce the ability of directors to evade the statute's enforcement of a meaningful standard to due care.\textsuperscript{275} More importantly, the statute avoids contractarians' objection to the expensive machinery of regulatory oversight.\textsuperscript{276} Here, "[t]he expensive legal system is not cranked up unless there is evidence of wrongdoing"\textsuperscript{277}—a form of deterrence accepted by contractarians in at least some contexts.\textsuperscript{278} Moreover, that benefit can be magnified by confining the proposed statute to clear and substantial showings of directors' breach of the duty of care.

Ironically, evidence exists that the market itself does not view stringent enforcement of fiduciary duties with automatic disfavor. On the contrary, one study\textsuperscript{279} of the aftermath of Van Gorkom disclosed a reaction at odds with contractarian premises about investor behavior. If shareholders truly prefer lax fiduciary restraints for which they have formally bargained to externally imposed stricter rules, then Van Gorkom should have undermined the appeal to investors of Delaware corporations. Conversely, the enactment of section 102(b)(7) should have restored the investor confidence that Van Gorkom presumably impaired. In fact, the correlation between those events and market value turned out the opposite of such predictions. The study found that Van Gorkom was not followed by a decline in the value of Delaware firms\textsuperscript{280} whereas the relative value of Delaware firms did drop significantly around the time that section 102(b)(7) became effective.\textsuperscript{281} Moreover, Delaware firms that amended their articles of incorporation to confer the protection authorized by section 102(b)(7) suffered abnormal losses during the period studied.\textsuperscript{282} While hardly conclusive, this evidence suggests that investors, whose sovereignty contractarians exalt, might welcome rather than resent legislation like the proposed fiduciary statute.

\textsuperscript{274} See Roberta Romano, Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws, 89 COLUM. L. REV. 1599, 1599-1602 (1989); supra note 271.

\textsuperscript{275} Of course a corporation could simply refrain from doing business in states passing such legislation. Cf. Stern, supra note 1, at 25-26 (avoiding state's exercise of jurisdiction over directors by barring sale of corporation's shares in that state). Widespread adoption of the statute, however, would impose significant limitations on the utility of this strategy.

\textsuperscript{276} See Easterbrook & Fischel, supra note 229, at 1421.

\textsuperscript{277} Id. 

\textsuperscript{278} See id.


\textsuperscript{280} Id. at 57-59.

\textsuperscript{281} Id. at 60-61.

\textsuperscript{282} Id. at 61-65.
In a larger sense, too, the proposed statute does not inherently clash with the operation of the market. Employed judiciously, government requirements can refine rather than impede market efficiency. For example, although some laissez-faire proponents have defended insider trading, disclosure requirements also invigorate the market by providing potential investors with a fair opportunity to assess the prospects of their transactions. The proposed fiduciary statute would further the broader aims of these laws, assuring investors of recourse should directors' irresponsibility disrupt the proper function of the market.

E. The Interests of Federalism

Contractarians' insistence on respecting the bargain that shareholders have struck in their charter dovetails with others' objection that extending domestic corporate law to foreign corporations vitiates the shareholders' selection of another state's corporate code. Thus, proponents of the contract model can invoke the principle of federalism, or at least a version that defers to the sovereignty of each state within its sphere. There are, however, other visions of federalism into which the proposed fiduciary statute comfortably fits.

To begin with, federalism's conception of institutional competence does not apply to the proposed statute. A major justification of federalism propounded by its earliest defenders is that states are inherently capable of performing some functions more effectively than the national government. The current patchwork of state-prescribed fiduci-
ciary duties, however, does not reflect a reasoned determination that this scheme is more efficient than a uniform federal standard. Rather, it simply arises from the historical accident of state predominance in the chartering of corporations in this country.\textsuperscript{290} This fortuity aside, a federal regime of corporate law, particularly fiduciary duties, would serve needs unfulfilled or undermined by the present system.\textsuperscript{291} Realistically, of course, the federal government is unlikely to undertake such regulation.\textsuperscript{292} The lack of federal involvement, however, highlights the proposition that the present allocation of authority is not mandated by a principled concept of federalism, but springs largely from inertia and self-interest. These forces do not justify rejecting the proposed fiduciary statute simply because it upsets the prevailing system of deference to the \textit{lex incorporationis} as the "font"\textsuperscript{293} of directors' powers and duties.

Assuming the continued lack of a federal role, the question remains whether the proposed statute upsets the proper balance of authority among co-equal state sovereignties. As has already been demonstrated, the statute would not violate limitations imposed by constitutional and choice-of-law requirements.\textsuperscript{294} Even from an equitable standpoint, however, the statute would not unduly encroach on


\textsuperscript{292} In construing federal legislation affecting duties to shareholders, the Supreme Court has consistently favored deference to state corporate law where the statute does not expressly preempt state standards. \textit{See} Burks v. Lasker, 441 U.S. 471, 478 (1979)(federal courts to apply state law governing authority of independent directors to terminate derivative suits to extent permitted under Investment Company Act and Investment Advisers Act); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977)(stating reluctance to "federalize" corporations law dealing with transactions and securities and refusing to apply substantive "'federal fiduciary principle'" under Rule 10 b-5); Cort v. Ash, 422 U.S. 66, 84 (1975)(state law to govern internal affairs of corporation except where "federal law expressly requires certain responsibilities of directors with respect to stockholders"). \textit{See also} Schreiber v. Burlington Northern Inc., 472 U.S. 1 (1985). Accordingly, assumption of federal responsibility for promulgating fiduciary rules would require an explicit congressional enactment. The political forces that could be expected to mobilize against such legislation, however, probably form an insurmountable obstacle. \textit{See} William L. Cary, \textit{supra} note 126, at 700; James William Hurst, Remarks, \textit{Symposium on Federal and State Roles in Establishing Standards of Conduct for Corporate Management}, 31 \textit{BUS. L. W.} 1185, 1191 (1976). The intense stake in charter fees alone, by those states that reap a substantial profit from incorporation, would probably trump the more abstract interest in uniformity and efficiency.

\textsuperscript{293} Burks v. Lasker, 441 U.S. 471, 478 (1979).

\textsuperscript{294} \textit{See} Stern, \textit{supra} note 1, at 34-60.
the appropriate prerogatives of states of incorporation. It is true that extending the reach of stricter fiduciary standards would reduce the attraction of states like Delaware as havens of permissiveness and hence threaten revenue from incorporation fees. It is equally true, however, that the option of reincorporation deprives states wishing to adopt higher standards of that same business. No neutral principle rooted in the benefits of federalism ratifies the superiority of the prevailing system, under which other states are practically compelled to emulate Delaware's laxity to avoid losing charters.

More positively, the proposed statute might serve loftier purposes of federalism by filling gaps left by federal reticence. The lack of substantive fairness requirements in the federal scheme of securities regulation, for example, invites states to develop such standards themselves. The statute represents one way in which states could increase their responsibility for the integrity of the market. If widely adopted, the statute might even eventually provide ordinary investors with protection similar to that received by consumers under the doctrine of unconscionability.

The ultimate aim of the proposed statute, however, is not simply to redress failure to act with sufficient care, but to prevent it. Ideally, the existence of outreach statutes would deter the sort of board lapses now effectively condoned by section 102(b)(7). Perhaps the enforcement of fiduciary obligation would inspire corporate boards' own "race to the top" to demonstrate the most responsible behavior. Indeed, even contractarians do not argue that shareholders would not benefit from directors displaying what is generally considered due care. Rather, they contend that government mandate of such conduct does not warrant the costs that regulation allegedly exacts.

While it is conceivable that the contractarians are right and that the proposed fiduciary statute would not accomplish its aims, this cannot be known unless legislation actually passes. Even failure of the statute, however, would vindicate a core value of federalism. The retention of significant powers in the states not only prevents dangerous

295. There are other reasons, however, why states might still prefer to incorporate in Delaware. See id. at 55 n.309.

296. Admittedly, some of the appeal of an outreach statute might lie in special advantages that the statute might confer on the enacting state and its residents. Most obviously, a successful suit would effectuate the transfer of wealth from directors to shareholders in the forum state. In addition, the prospect of recourse for negligence might encourage investment by residents of the state, thus increasing representation from that state within numerous corporations. Again, though, however self-seeking these motives, they do not threaten the assumptions of federalism.


accumulation of power in the national government; it also enables states to act as laboratories for the trial of innovative legislation. Since the regime dominated by section 102(b)(7) and its imitators has hardly been shown to be a resounding success, the different approach of a fiduciary outreach statute deserves its turn in the caldron of state experimentation. The contractarians, so proud of their scientific rigor, should not object to a fair test of this novel kind of corporate law.

IV. CONCLUSION

Without question, the proposed outreach statute would represent a notable departure from prevailing notions of directors' accountability. Because of the statute's novelty, it is easy to exaggerate the difficulties and drawbacks in enforcing such legislation. While these obstacles are not illusory, neither are they insurmountable.

The multistate class action envisioned by passage of several outreach statutes cannot be regarded as inherently unmanageable. On the contrary, the fears after Shutts that this type of suit would inevitably generate intolerable costs and unfairness appear not to have been realized. As Part II demonstrates, there is nothing peculiar to shareholder actions under the proposed legislation that would preclude states from conducting them in an orderly fashion as well. In particular, the specter of duplicative litigation fades upon closer consideration.

Legitimate concern that the duty of care is not adequate to the task of fostering responsible behavior by directors is rooted in widespread legislative and judicial reluctance to enforce meaningful standards of due care. By the very act of passing the proposed statute, however, a state would signal its resolve not to be bound by a crabbit sense of fiduciary obligation. Legislative adoption would reverse the evisceration of shareholder remedies for negligence wrought by section 102(b)(7) and comparable statutes in the wake of Smith v. Van Gorkom. Moreover, an outreach statute could instruct courts not to apply the toothless version of the duty of care thought to prevail in fiduciary jurisprudence. Rather, courts could follow the example of those decisions recognizing that review for due care entails more than a virtual rubberstamp under the aegis of judicial deference to directors' expertise. In particular, the statute could authorize candid appli-

299. See Rapaczynski, supra note 288, at 388-89.
301. See supra note 256 and accompanying text.
cation of substantive standards long implicit in the concept of due care.

Finally, while it is likely that few legislators would ground their resistance to the proposed statute in conscious adherence to the contract model of corporations, contractarian commentary has contributed significantly to widespread skepticism toward such interference with shareholders' "voluntary" agreements. Accordingly, Part III has sought to show that the contract model does not provide an infallible guide to corporate governance. On the contrary, both normative and empirical grounds exist upon which a state might choose to enforce mandatory fiduciary duties against directors who deal with its residents. Indeed, in some ways, contractarians' own premises about market behavior and about the superiority of experience to abstraction support experimenting with the proposed outreach statute.

The issue ultimately raised by the proposed statute is whether the current relaxed regime governing directors' duties in fact maximizes the welfare of shareholders. Enough evidence exists to the contrary to warrant trying to impose accountability. Little lasting harm seems likely to result should outreach legislation fail to achieve its aim, whereas success might bring substantial benefits, not the least of which would be a revived interest in the responsibility of directors.