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Self-Regulation, Normative Choice, and the Structure of Corporate Fiduciary Law

William W. Bratton*

Introduction

The American Law Institute (ALI) chose an awkward time to formulate the code of corporate fiduciary duties in Part V of its *Principles of Corporate Governance (Principles)*.¹ Confidence in fiduciary law diminished while this body of rules and standards went through a long process of drafting and approval. Its drafters had the difficult assignment of formulating “principles” for fiduciary law’s future development—rather than merely “restating” past rulings—at a time when no consensus existed in the legal community as to why corporate law imposes fiduciary duties or what the operative “principles” of corporate fiduciary law ought to be.²

This open conceptual background left the drafters considerable room to choose the code’s contents, even as it complicated the job

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1. AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Proposed Final Draft 1992) [hereinafter Proposed Final Draft]. This Article focuses on the basic outline of fiduciary rules set out in Part V. It does not take up the specialized applications of fiduciary rules in the *Principles*’ sections on mergers and takeovers.

2. While the *Principles* went through a series of tentative drafts during the 1980s, academics and policymakers moved away from the view that corporations should be subject to more stringent fiduciary regulation and considered instead the deregulatory implications of a microeconomic vision of the corporation. Later, as the *Principles* moved toward final form, the academics turned away from that deregulatory microeconomic story to consider new modes of corporate self-regulation in microeconomic terms. See *infra* Part II.A.

of articulating a set of best “principles.” If the drafters’ decision-making process were set out for inspection, we would learn much about the “principles” that inform today’s corporate law. But, unfortunately, the drafters do not describe their work in terms of choices between and among competing principles. Their extensive commentaries are in a bald, doctrinal style that invests results with the appearance of inevitability by obscuring the presence of political and economic contingencies.

This Article takes the liberty of explicating some of the choices implicit in the structure of the ALI’s fiduciary code. It identifies two potentially conflicting objectives. The drafters chose, on the one hand, to confirm the legitimacy of corporate fiduciary law’s traditional fairness norm. On the other hand, they also chose to mandate a role for business people in the norm’s future articulation. These objectives have a mutually resistant aspect. The drafters, recognizing this, did not attempt to meld them together into a directive blueprint. Instead, they gathered them into a framework that encourages the mediation of corporate disputes even as it puts them on a track for legal decision. In addition, they kept the legal description of the corporation that informs the framework flexible and open to situational modification.³

The *Principles*, then, give us corporate fiduciary law on an open-ended foundation. The drafters begin with a traditional fiduciary norm. They then attempt to avoid problems intrinsic to its imposition in business situations by making normative judgments context-specific, bringing regulated actors into the judgment process, and delaying the participation of outside regulators. The question is whether this strategy privileges self-regulation at the expense of the traditional fiduciary norm, or strengthens the norm by assuring relational sensitivity in its application. Will the code, by virtue of its flexibility and capaciousness, help restore confidence in fiduciary principles? Or will it encourage their marginalization by inviting a new round of substantive dilution?

The drafters recommend no solution to this problem of self-regulation and normative choice.⁴ This Article, taking another liberty, does make a recommendation. It suggests that traditional fiduciary norms still play a vital role in corporate governance, and that the code should be read as an emphatic restatement of those norms.

3. Academic theory is virtually the only thing the drafters exclude from the model. Both antimanagementist notions of fiduciary regulation and the microeconomic model of the corporation are largely absent.

4. The outcome depends on how legal decisionmakers go about applying the code, assuming they apply it at all. Although nothing requires them to follow it, it probably will be influential. It is already an authoritative source of fiduciary doctrine, and thus will exert influence comparable to a leading reference tool. Given the imprecise nature of fiduciary doctrine, it is therefore well-positioned to influence behavior.

The code's expansion of business peoples' decisionmaking role need not, and indeed should not, imply the subordination of the law's substantive principles.

Part I of the Article summarizes the code and its drafters' commentaries. Part II describes volatile theoretical discussions that went on in the background while the drafters did their work. It supplements the drafters' commentaries by describing their implicit choices, and defends their flexible, mediative approach. But the defense leaves open a question—whether the code's flexibility implies dilution of the fairness standard. Part III addresses this question and provides a partial answer. It asserts, first, that traditional fiduciary concepts retain vitality in corporate contexts and, second, that this code should be applied and interpreted to maintain their integrity.

I. *The Principles' Duty of Fair Dealing*

The *Principles* impose fiduciary duties on corporate directors, officers, and controlling shareholders⁵ in a code of sixteen sections.⁶ This code synthesizes a large body of cases and statutes covering the traditional range of self-dealing transactions including contracts between directors and officers and the corporation,⁷ compensation arrangements,⁸ corporate opportunities,⁹ and competition with the corporation.¹⁰

The code begins by changing the name of this body of law. It drops the old appellation "duty of loyalty" and substitutes "duty of fair dealing," drawn from contract law.¹¹ The drafters offer a technical explanation for this change: In the class of cases where the corporate entity is not the beneficiary of the duty, it is not clear to whom the fiduciary owes the "loyalty" specified in the old title; changing the title dispels the ambiguity.¹² This explanation, however, does not satisfy fully. The possibility that the titular change has substantive implications needs to be addressed.

The code's duty, though newly titled, has deep historical roots. A traditional fairness concept provides its normative center of gravity. But the drafters, though they draw on history, express a desire to break with it. They do not want the traditional fairness concept to be applied in a traditional conceptual manner. Fiduciary law, they

5. Proposed Final Draft, *supra* note 1, § 5.01.

6. *Id.* §§ 5.01-5.16.

7. *Id.* § 5.02.

8. *Id.* § 5.03.

9. *Id.* § 5.04.

10. *Id.* § 5.06.

11. *Cf.* U.C.C. § 2-103(1)(b) (1989) (defining "good faith," the contract law concept most closely resembling the duty of loyalty, as "honesty in fact and the observance of reasonable standards of fair dealing in the trade").

12. Proposed Final Draft, *supra* note 1, Part V introductory note a, at 264.

tell us, is not a set of rules that, properly applied, yields precise answers.¹³ Under these “principles” of corporate governance, then, fairness will not acquire meaning as a matter of deduction from a set of first principles embedded in legal doctrine; its substantive meaning instead will emerge in particular decisionmaking contexts.

The question is whether the change in title also heralds a break with history. Its reference to the fairness standard of contract law implies a shift away from an externally imposed standard of selflessness to a legal environment more tolerant of self-interested wheeling and dealing. As the discussion that follows shows, some parts of the code confirm the suggestion of substantive relaxation, while other parts do not.

A. Process—*The Legal Effect of Disinterested-Director Approval*

Fiduciary law’s traditional fairness standard imposes a norm of selfless conduct on corporate actors. The *Principles’* code adopts that standard, but then retards the norm’s imposition by restricting the scope of judicial review. This restriction is another break with history. Under the present law of most states, the norm may be imposed freely. Access to judicial review is open; absent shareholder ratification, management self-dealing transactions are subject to direct judicial scrutiny for fairness.¹⁴ The code partially closes this door to judicial review by introducing a sliding scale of standards of review keyed to a corporation’s internal decision making processes. The code subjects a transaction between a corporation and a director or officer to full fairness scrutiny with the burden of proof on the defending officer or director only in cases where the transaction has not been approved by disinterested directors or disinterested shareholders.¹⁵ When disinterested-director or shareholder approval follows full disclosure, the burden of proof shifts to the challenging plaintiff and the standard of review is restricted.¹⁶ With disinterested-director approval, later judicial review does not go to the terms of the transaction directly. Instead, the judge reviews the transaction from the viewpoint of the disinterested director who approved it.¹⁷ If the “director reasonably could have concluded that

13. According to the drafters, old phrases like “intrinsic fairness” and “entire fairness” suggest “an often unattainable degree of precision in analysis.” *Id.* § 5.02(a)(2)(A) cmt., at 289-92. I impute this purpose to the drafters in the light of the title change.

14. *See id.* § 5.02 reporter’s note 1, at 312-15 (describing the state statutes).

15. *Id.* § 5.02(a)(1)-(2).

16. *Id.* § 5.02(b).

17. Unless the action of the approving directors violates the duty of care, the plaintiff will have a damages action only against the interested director. A violative transaction also can be rescinded. *Id.* § 5.02(a)(2)(B) cmt., illus. 9, at 295-96.

the transaction was fair to the corporation” at the time of authorization, no breach of duty has occurred.¹⁸ Ratification by disinterested shareholders has the same effect as under prior law and further contracts the standard of review to a search for waste of assets.¹⁹

This three-tiered system can be explained in neutral, technical terms. It rationalizes a longstanding anomaly in the structure of state law. Most states have safe-harbor statutes for self-dealing transactions.²⁰ Read literally, these statutes shield self-interested transactions from subsequent challenge for breach of the duty of loyalty if the proponent obtains disinterested-director or shareholder approval upon full disclosure. Under this literal reading, the statutes transform fiduciary law into a self-regulatory system: The regulated entity imposes the norm, and the state enforcement apparatus reviews not the substantive judgment but the circumstances surrounding its imposition. Courts, however, have not read the statutes literally. They have consistently construed them to permit direct judicial review for fairness despite disinterested-director approval.²¹ This restrictive reading leads to a technical question that the case law has never answered: If the statutes do not mean what they seem to say, what then do they mean? The cases leave a bundle of factors circulating indistinctly—disinterested-director approval, shareholder approval, fairness scrutiny, waste scrutiny, business-judgment scrutiny, and different placements and standards of the burden of proof.²² The *Principles*' code ties these factors into a working whole.

But the code makes more than just a technical adjustment. By according qualified recognition to disinterested-director approval, the code makes a crucial nod in the direction of corporate self-regulation. Disinterested-director approval is the corporate response to self-dealing transactions most likely to be employed in the ordinary course of business. Unlike shareholder approval, it is obtainable at relatively low cost and with limited publicity.²³ To accord this process anything approaching preclusive legal effect, however, threatens the integrity of the norm of selfless conduct. Disinterested

18. *Id.* § 5.02(a)(2)(B).

19. *Id.* § 5.02(a)(2)(D).

20. *Id.* § 5.02 reporter's note 1, at 312-15.

21. *See, e.g.,* Scott v. Multi-Amp Corp., 386 F. Supp. 44 (D.N.J. 1974); Aronoff v. Albanese, 446 N.Y.S.2d 368 (1982); Flieger v. Lawrence, 361 A.2d 218 (Del. 1976); Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66 (Cal. Ct. App. 1952).

22. Some cases have suggested that the existence of internal corporate approval processes at least should shift the burden of proof of fairness to the plaintiff. *See* Proposed Final Draft, *supra* note 1, § 5.02 reporter's note 1, at 312-15. It also has been suggested that those processes should change the standard of review to waste, at least when shareholder ratification has occurred. *Id.* reporter's note 7, at 321-22. But no generally accepted legal effect has emerged for disinterested-director ratification. *See id.* § 5.02 reporter's note 1-9, at 312-23; *see also* Ahmed Bulbulia & Arthur R. Pinto, *Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards?*, 53 *NOTRE DAME L. REV.* 201, 203-04 (1977).

23. For reporting companies under the Securities Exchange Act of 1934, 15 U.S.C. § 78-78kk (1988 & Supp. III 1991) (as amended), shareholder ratification requires compliance with the federal proxy rules. *See* SEC Solicitation of Proxies Rule, 17 C.F.R. § 240.14a-2 (1992).

directors, as colleagues of the interested directors, often approach self-dealing transactions in a spirit of accommodation.

The code's drafters recognize this problem and search for an intermediate approach.²⁴ Their new standard of scrutiny—reasonableness review of the directors' fairness determination—imports stricter scrutiny than would the business judgment rule, but also purports to block full fairness review by the courts.²⁵

At bottom, then, the *Principles* set up a rebuttable presumption in favor of validating self-dealing transactions approved by disinterested directors. Unfortunately, the drafters do not fix the difficulty of rebuttal precisely; they leave this task to a case-by-case determination.²⁶ The courts that decide those cases, in effect, will make a

24. See Proposed Final Draft, *supra* note 1, § 5.02(a)(2)(B) cmt., at 292-300 (stating that disinterested-director approval upon full disclosure is not the substantive equivalent of arm's-length transacting).

25. Compare *id.* § 4.01(c)(3) (phrasing the business judgment rule in terms of rational belief in the corporation's best interests) with *id.* § 5.02(a)(2)(B) (stating that a disinterested director approving a self-dealing transaction must reasonably conclude that the transaction is fair to the corporation). The drafters predict that the erection of a business-judgment shield to protect self-dealing transactions would not work in any event. In their view, the courts would unduly broaden such a rule in order to scrutinize the transactions. *Id.* § 5.02(a)(2)(B) cmt., at 292-300.

26. The code's choice to accord legal effect to boardroom conflict resolution applies to all types of self-dealing transactions. *Id.* Part V introductory notes, at 263-70; *id.* § 5.01 cmt. c, at 271-72. The particular effect varies with the circumstances. For self-interested dealings such as contracts with the corporation or personal use of the corporation's property, disinterested-director approval shifts the burden of proof to the challenging party, and the substantive result can be voided only if the approving directors could not "reasonably have concluded that the transaction was fair to the corporation . . ." *Id.* §§ 5.02(a)(2)(B), 5.04(a)(1), 5.04(a)(4), 5.04(b). In cases of executive-compensation arrangements, competition with the corporation, and board decisions to decline corporate opportunities made available by directors or officers interested in their private pursuit, the code shifts the burden of proof and restricts the reviewing court to business-judgment scrutiny. *Id.* §§ 5.03(a)(2), 5.03(b), 5.05(a)(3)(B), 5.05(c), 5.06(a)(2), 5.06(b). In the case of a transaction between a corporation and a controlling shareholder, the effect is more limited: The burden of proof shifts to the challenging party, *id.* § 5.10(b), but the standard of scrutiny remains fairness, *id.* § 5.11(b).

Under the code, a plaintiff who seeks to invalidate a transaction approved by disinterested directors would be best advised to attack the adequacy of the board-approval process. As a practical matter, a plaintiff must establish that the benefitted party obtained approval without disclosing a material fact. *Id.* § 5.02(a)(1); see also *id.* § 1.14(a) (defining conflict-of-interest disclosure); *id.* 1.14(b) (defining transaction disclosure). On its face, § 5.02 makes adequate disclosure an independent requirement. Under § 5.02(a)(1), if the interested party has not made adequate disclosure to the corporate decisionmaker approving the transaction, the standard is violated without further inquiry into the fairness of the transaction. This formulation is stricter than that contained in many state statutes. See, e.g., DEL. CODE ANN. tit. 8, § 144(a)(3) (repl. vol. 1991) (stating that adequate disclosure is not required if the suspect transaction is "fair to the corporation").

The *Principles'* drafters, having put forth disclosure as the key to boardroom approximation of an arm's-length bargain, nonetheless draw back from the prospect of questions of liability for breach of duty turning on ex post judicial scrutiny of that disclosure's adequacy. First, they stress that failure to disclose constitutes grounds for rescission but does not imply necessarily that the transaction has damaged the corporation. The defendant in such a case still may prove that the transaction was fair, and that the corporation, accordingly, suffered no damage. See Proposed Final Draft, *supra* note

normative choice that the drafters defer. They will determine the extent to which boardroom regulation of conflict-of-interest transactions entails relaxation of the fiduciary norm.

B. Fairness

1. Directors' and Officers' Self-Dealing Contracts

The code's concept of "fairness" is open-ended. The drafters do not attempt to define the term, presumably intending that its meaning emerge in particular contexts, but they do report some definite ideas on the subject. The code contemplates "objective" scrutiny of self-dealing transactions: The deals must fall within the "range of reasonableness."²⁷ As to contracts between directors and officers and the corporation, the drafters' draw on antecedent law to suggest three yardsticks for determining what is reasonable. The first is contractual—the transaction must be compared to an arm's-length transaction involving the same subject matter. The second looks to corporate purpose—the transaction must further the corporation's best interests in the sense of being a transaction into which the corporation would enter even absent the self-interested tie.²⁸ The third is procedural—the approval process must show no undue pressure or other taint.²⁹

Disinterested-director approval relaxes the intensity of the fairness inquiry but does not change its substance. Under the relaxed standard, the reviewing court must decide that the transaction was "so clearly outside of the range of reasonableness" that the directors could not have concluded reasonably that it was fair.³⁰ This standard contemplates something stricter than business judgment review. The code instructs the court conducting the inquiry to make a critical inspection of the entire record. Assume, for example, that a director owns a property. The director has marketed the property for \$7.5 million but has only received bids in a range of \$3 to \$5 million. The director then sells the property to the corporation for \$7.5 million. A disinterested board approves the purchase based on an expert report which concludes that the property might be worth \$7.5 million but that this sum lies at the high end of the range. The reviewing court, under the code, may look past the boardroom record and conclude that the approving directors did not have an adequate basis to support their conclusion that the transaction was

1, § 5.02(a)(1) cmt., at 285-88. Furthermore, under § 5.02(c), defective disclosure can be cured, even after the filing of a suit, by ratification of the transaction after full disclosure. *Id.* § 5.02(c). The level of scrutiny accorded the transaction after the cure varies with the culpability of the earlier failure to disclose. If the nondisclosure involved bad faith, the original approval of the transaction has no legal effect and fairness scrutiny obtains. In the case of less culpable failures to disclose, the cure may relate back to the original approval to preclude scrutiny under the fairness standard. *See id.* § 5.02(c) cmt., at 308-12.

27. *Id.* § 5.02(a)(2)(A) cmt., at 289-92.

28. *Id.*

29. *Id.*

30. *Id.* § 5.02(a)(2)(B) cmt., at 292-300.

reasonable.³¹

2. Other Self-Dealing By Directors and Officers

As to director and officer self-dealing transactions, the code restates the fairness standard of current law but then constrains its application if disinterested directors sanction the transaction at issue. In treating some other situations, by contrast, the drafters take steps to compensate for the limited review following disinterested-director approval by strengthening the applicable fairness standards.³²

The code's rule respecting uses of corporate property is particularly notable in this regard.³³ It amounts to an open-ended unjust-enrichment standard. Section 5.04 contains a general prohibition against the use of corporate property, corporate position, or material nonpublic corporate information to secure a pecuniary benefit

31. *Id.* § 5.02(a)(2)(B) cmt., illus. 9, at 295-96. For a second example, assume that a disinterested board approves a sale of property to the corporation at a high price based on an inside appraisal they know to be unreliable and substantially higher than an earlier outside appraisal. *Id.* § 5.02(a)(2)(B) cmt., illus. 10, at 296-97. Here too the court can disregard the corporate record and conclude that the board did not have a basis for concluding the transaction to be fair.

This fairness inquiry, as articulated with regard to self-dealing contracts, is well-mapped territory. The *Principles* here restate antecedent substantive law, but depart from it to restrict the scope of review in deference to disinterested-director determinations.

One other departure from prior law bears mention. The code constructs a new safe harbor for transactions between companies with common directors absent personal participation or negotiation by the director with the conflict. *Id.* § 5.07. According to the comment, only older cases apply fairness scrutiny to these transactions on a per se basis. *Id.* § 5.07 cmt. a, at 412-13.

This relaxation of the rules attending interlocking boards accords with the spirit of our times. Interlocking boards were a political issue during the early part of this century, when proponents of industrial and financial cooperation battled proponents of vigorous antitrust enforcement. See RON CHERNOW, *THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE* 176-77 (1990) (describing Louis Brandeis' opposition to interlocking directorates between banks and industrial corporations). Lately, the tendency is to stress the productive benefits of cooperative ties. See, e.g., Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 *YALE L.J.* 871, 904-05 (1992) (describing the productive relationship that rests on "cross-ownership" in Japan).

32. Consider, for example, the *Principles'* treatment of corporate opportunities. Proposed Final Draft, *supra* note 1, § 5.05. This section confirms that full-time officers have a duty to present opportunities in those lines of business that the corporation expects to engage in, as well as in its present lines of business, without regard to the opportunity's source or the capacity of its acquisition. *Id.* § 5.05(b)(2) (stating that an officer must "know" that the activity is "closely related" to a business in which the corporation "expects" to engage). Here the drafters opt to follow the stricter rule of *Rosenblum v. Judson Engineering Corp.*, 109 A.2d 558, 563 (N.H. 1954) (holding that the corporate opportunity doctrine applies where the opportunity is such that it should fairly belong to the corporation), over that of *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (holding the officer to a duty of good faith under the corporate opportunity doctrine).

33. See Proposed Final Draft, *supra* note 1, § 5.04.

unless the use falls within listed exceptions.³⁴ The rule breaks new structural ground³⁵ by synthesizing a range of antecedent cases, many of which appear to have little in common. For example, the section's concept of use of property for "pecuniary benefit" encompasses both the sale of a corporate office³⁶ and the act of preventing the corporation from pursuing an activity that the director desires to pursue for his or her own account.³⁷

More controversially, the section makes insider trading a breach of fiduciary duty. A long line of authority holds that insider trading does not breach the duty of loyalty because the corporation suffers no injury.³⁸ The drafters reject this approach and draw on the misappropriation theory of federal insider-trading law to apply an unjust-enrichment characterization; the trader uses a corporate position to secure an unauthorized benefit and therefore breaches the duty of fair dealing.³⁹

This treatment of insider trading has paradigmatic implications; it traverses a distinction long thought fundamental to the structural model of corporate law. Historically, the duty of loyalty is owed to the corporate entity and covers conduct pursued in a corporate capacity—that is, in the performance of a directorship or other office—as opposed to conduct pursued in a shareholding capacity. Transactions in shares fall outside of the traditional scheme of fiduciary duties; a norm of self-interest has prevailed with respect to shareholder activities.⁴⁰ Of course, this classical corporate distinction between corporate-level and shareholder-level activities has been much modified in some cases,⁴¹ but it has nevertheless persisted in the law. The code's drafters break with history to disregard

34. *Id.* § 5.04(a). The exceptions contemplate, among other things, that uses of corporate property may be qualified as self-dealing transactions through disinterested-director or shareholder approval, or qualified as compensation arrangements. *Id.* § 5.04(a)(1), .04(a)(2), .04(a)(4). The upshot is that the chief executive officer who takes the corporate jet to a resort for a personal vacation must pay unless the use previously was included in the corporation's compensation plan as a job requisite. *See id.* § 5.04 cmt. d(3), at 368-74.

35. As usual, however, the drafters carefully limit the remedy. Here it is restricted to the return of the improper benefit and liability for any foreseeable harm to the corporation. *Id.* § 5.04(c).

36. *Id.* § 5.04 cmt. d(1)(f), at 359.

37. *Id.* § 5.04 cmt. d(1)(d), at 355-56.

38. *See, e.g.,* *Bisbee v. Midland Linseed Prods. Co.*, 19 F.2d 24, 27-28 (8th Cir.), *cert. denied*, 275 U.S. 564 (1927); *Steven v. Hale-Haas Corp.*, 23 N.W.2d 620, 627-32 (Wis. 1946).

39. Proposed Final Draft, *supra* note 1, § 5.04 cmt. d(2)(a), at 360-64; *see* *Diamond v. Oreamuno*, 248 N.E.2d 910, 912 (N.Y. 1969). *But see* *Freeman v. Decio*, 584 F.2d 186 (7th Cir. 1978) (rejecting the misappropriation theory under Florida law).

40. The self-interest norm is embedded in the rule that controlling shareholders can sell their shares at a premium, above-market price without sharing with other shareholders. *See, e.g.,* *Zetlin v. Hanson Holdings, Inc.*, 397 N.E.2d 287 (N.Y. 1979). For the classic statement of the self-interest norm with respect to the vote, see *Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling*, 53 A.2d 441 (Del. 1947) ("a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit").

41. *See infra* note 59.

it entirely. Their "duty of fair dealing" is owed to both the corporation and its shareholders⁴² and thus cuts across the old categories. One result is that inside information easily can be characterized as corporate property, and its use in trading can become a breach of duty without a corporate-level injury.⁴³

3. Shareholder Freezeouts as Director Self-Dealing

The code's elimination of the classical distinction between corporate- and shareholder-level duties necessitates structural adjustments. Primary among them is the inclusion of manipulation-of-dividend policy as one of the unfair uses of "corporate position" under section 5.04. Purposeful distribution of a benefit to shareholders qua shareholders by means other than payment of dividends violates the section if some shareholders are unable to take advantage of the benefit.⁴⁴ The result is that close-corporation freezeouts, historically thought to give rise to breaches of duty at the shareholder level, fall into the same category as director and officer breaches. As with insider trading, the drafters relax the historical requirement of injury to the corporation. The prohibited combination of earnings retention and unequal distribution of employment benefits causes the corporate entity no harm. The gravamen of the breach is injury to the shareholder by virtue of unequal distribution of benefits.

It should be noted that this treatment of freezeout transactions does not break new ground by changing the results of cases. The shareholder-level duty is now well-established. The drafters innovate, however, by implying that equal treatment of shareholders is a norm of equal dignity with the notion of loyalty to the corporation as a whole.⁴⁵ Although they do not expand or intensify the notion of fairness operating in present law expressly, the drafters clear a path that invites such results in future cases.⁴⁶

42. Proposed Final Draft, *supra* note 1, § 5.04 cmt. d(2)(a), at 360-64.

43. Section 5.04's rules against the use of corporate information for personal benefit balance the individual insider's interests in profitmaking pursuits against the firm's collective interest. Under § 5.04(a)(3), corporate information generally may not be used for personal advantage unless (a) it is not inside information used in the trading of the firm's securities, (b) it is not information designated as proprietary by the corporation, or (c) its use does not harm the corporation. *Id.* § 5.04(a)(3). Thus, an employee may use corporate information in formulating a personal investment strategy, or may use nonproprietary information when taking employment elsewhere. *See id.* § 5.04 cmt. d(2)(b), at 364-68.

Interestingly, under the code's unjust enrichment theory of insider trading, tipping is not a breach of duty per se. A breach occurs only if the tipper takes a cut of the tippee's profits, or if the corporation incurs costs as a result of an SEC enforcement proceeding. *Id.* § 5.04 cmt. d(2)(b), *illus.* 17, at 367.

44. *Id.* § 5.04 cmt. d(1)(c), at 353-55.

45. *See also supra* text accompanying notes 40-43.

46. The *Principles'* treatment of the creditors' interest in the corporation makes a

4. Duties of Controlling Shareholders

A substantive corporate-level/shareholder-level distinction does survive in the code. The code applies different procedures and fairness standards depending on the capacity in which the corporate actors act. Freezeouts are treated as corporate-level breaches because they result from the use of corporate property or office by directors or officers. In the freezeout fact pattern, the culpable directors and officers are also controlling shareholders, and the unequal distribution that violates their duty occurs at the shareholder level. But these culpable players do not undertake the breaching actions in a shareholding capacity.

Where a controlling shareholder interacts directly with the corporation—for example, where a parent corporation contracts or interferes with a majority-owned subsidiary—the code treats the case as a separate suspect transaction.⁴⁷ It sets out standards for three such

notable point of contrast. The drafters take “no position” on the matter of corporate duties to creditors. *Id.* § 5.04 cmt. c(1), at 341-43. They acknowledge that some observers favor a duty to creditors, but note that Part V “does not treat” the matter as such, leaving creditor protection to contract and bankruptcy law. *Id.* § 5.04 reporter’s note 12, at 376-77; *see also id.* § 5.04 cmt. d(2)(a), at 364 (noting that Part V does not address trading in debt securities).

The drafters show only slightly more solicitude for the interests of preferred stockholders. So long as the directors do not advance personal pecuniary interests, the drafters would accord deference to the directors’ decision to favor one class of preferred stock over another with respect to dividends or redemption. Failure to respect contract rights should result in a contract claim, not a claim for breach of fiduciary duty. *Id.* § 5.04 reporter’s note 7, at 376. *Zahn v. TransAmerica Corp.*, 162 F.2d 36 (3d Cir. 1947), is carefully limited: Controlling shareholders have a duty not to use corporate property in a manner that excludes other “similarly situated” shareholders from participation in profits. Proposed Final Draft, *supra* note 1, § 5.11 cmt. d(1)(d), at 355-56; *id.* reporter’s note 7.

There is sufficient similarity between bonds, preferred stock, and common stock—viewed from the point of view of investors—to make the drafters’ distinction hard to defend. *See generally* William W. Bratton Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92, 98-101 (identifying three conceptions of corporate debt relationships and evaluating their role in response to restructuring related wealth transfers); Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. Rev. 1165, 1167-71 (1990) (examining the nature of corporate fiduciary relationships in the context of bondholders’ rights). The remission of the question of equal treatment of preferred stock to the category of business judgment matters is particularly surprising in view of the warmth with which the drafters embrace the idea of equal treatment of common stockholders in § 5.04. Nor does the device of “taking no position” on the subject of duties to creditors seem effective for its intended purpose. Even as they refrain from articulating a position, the *Principles* strongly imply that senior-security protection should be a contractual proposition.

This treatment of senior securities strikes a dissonant note in the code. So far as shareholder-to-shareholder relationships are concerned, the drafters rework the law’s very structure to embed in it a fairness principle previously articulated in a small but important body of cases. Senior-security holders are remitted to their contract rights without discussion, even though they suffer many of the same problems of nonreciprocal treatment and unanticipated opportunism. Moreover, at least where close corporations are concerned, shareholders have as much opportunity to protect themselves by contract as do bondholders. *See infra* Part I.B.4.

Of course, lines do have to be drawn, and the code’s line accords with the views of the overwhelming majority of observers. *See, e.g.*, Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821 (1992); John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO. L.J. 1495 (1990). So noting, however, does not make the line any less arbitrary.

47. *See infra* notes 51-53 and accompanying text. These sections substantiate the

situations. First, for transactions between a controlling shareholder and the corporation, it articulates a fairness standard.⁴⁸ Second, carrying forward the principle of section 5.04, it rules that a controlling shareholder may not use corporate property or its control position to secure a pecuniary benefit unless value is given and the transaction is fair, or the benefit is made proportionately available to other shareholders.⁴⁹ Finally, it extends a modified version of the corporate-opportunity rule to controlling shareholders.⁵⁰

Judicial scrutiny here is stricter than elsewhere in the code. The basic test is fairness, without provision for an automatic reduction in scrutiny upon approval by disinterested directors.⁵¹ The drafters apparently assume that parents so control their subsidiaries' board rooms as to make pointless a provision for corporate-level input on the question of fair treatment. But, drawing on *Weinberger v. UOP, Inc.*,⁵² the drafters indicate that procedural considerations still will figure into judicial fairness determinations in these cases. The starting point for procedural fairness here, however, is not disinterested-director approval, but the stronger check of the independent negotiating committee.⁵³

The drafters thus make it harder to qualify these transactions procedurally. They go on, however, to compensate for this stricture by narrowing the substantive scope of the underlying duty. The controlling shareholders' duty, if articulated as an exact parallel of the directors' and officers' duty imposed by the code, would prove monumentally inconvenient to parent corporations. For example, the

holdings of leading majority-to-minority shareholder cases like *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464 (Cal. 1969), *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971), and *Greene & Co. v. Dunhill International, Inc.*, 249 A.2d 427 (Del. Ch. 1968).

The fairness duty obtains even though in the case of a controlling corporate shareholder the managers making the decisions owe conflicting fiduciary duties to a second set of shareholders. Proposed Final Draft, *supra* note 1, § 5.10 cmt. f, at 443-45.

48. Proposed Final Draft, *supra* note 1, § 5.10(a).

49. *Id.* § 5.11(a)(1)-(2). Section 5.11 sweeps in most majority-to-minority fact patterns not involving transactions. It covers, among other things, the parent's (a) misusing a corporate position to obtain a tax benefit at a subsidiary's expense, (b) misusing dividend policy, (c) precluding a subsidiary from engaging in a business opportunity, (d) precluding a subsidiary from competing with a parent, and (e) obtaining profit from the sale of property to the exclusion of other shareholders. *See id.* § 5.11 cmt. a, at 448-50.

50. *Id.* § 5.12(a). This section's definition of corporate opportunity is narrower than that in § 5.05(b) because the drafters assume that controlling shareholders have a right to engage in competition with controlled corporations. *Id.* § 5.12 cmt. d, at 471-77. As a practical matter, then, this corporate opportunity bar extends only to opportunities developed by a subsidiary and opportunities that come to a parent corporation by virtue of its relation to the subsidiary. *Id.* § 5.12(b)(1), (2).

51. *Id.* § 5.10(a)(2), (b) (stating that disinterested-director ratification of control shareholder engagement with corporation shifts burden of proof but does not change standard of review); *id.* § 5.12(a)(2) (stating that disinterested-shareholder ratification is necessary to insulate control shareholder from taking of corporate opportunity).

52. 457 A.2d 701 (Del. 1983).

53. Proposed Final Draft, *supra* note 1, § 5.10 cmt. e, at 440-43.

parent would have to channel significant business opportunities to the subsidiary⁵⁴ and would be constrained from competing with it.⁵⁵ Mandated selflessness of this intensity would as a practical matter encourage the parent to eliminate the conflict of interest by means of a cash-out merger of the minority shares.⁵⁶ The code's drafters draw the line before this point is reached. Although the controlling shareholder/parent may not prevent the subsidiary from competing with it, it has no duty to provide the subsidiary with the resources needed for competition, and, indeed, may compete with the subsidiary to its injury.⁵⁷ Similarly, the corporate-opportunity bar applied to controlling shareholders is defined narrowly.⁵⁸

5. *Sales of Control*

The code's constraints on the use of corporate position for personal gain invite application to a case where a controlling shareholder sells stock at a premium price. Because such a sale customarily entails stage-managed changes in board composition and office holding, it arguably involves the "use" of corporate positions. If further reference is made to the code's principle of equal distribution of benefits among shareholders, then a basis arises for imposing premium participation rights for outside shareholders upon the sale of a control block.⁵⁹ But here again, the drafters carefully draw a line against the extension of their own equality principle. Under Section 5.16, premium sales of controlling blocks constitute a breach of a duty to other shareholders only in two narrowly defined classes of cases.⁶⁰

54. *Cf. id.* § 5.05(b).

55. *Cf. id.* § 5.06(a).

56. *Cf. Victor Brudney & Robert C. Clark, A New Look at Corporate Opportunities*, 94 HARV. L. REV. 997, 1057-1058 (1981) (proposing a sharing rule for these situations as a means to encourage cash-out mergers).

57. Proposed Final Draft, *supra* note 1, § 5.11 cmt. c(1), at 450-52; *id.* c(2)(B), at 453-55; *id.* d(1)(a), at 457-59.

58. *See supra* note 50.

59. Such a system was, of course, advocated by a generation of commentators. The primary exposition is William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 515-17 (1965). For support, see Victor Brudney, *Fiduciary Ideology in Transactions Affecting Corporate Control*, 65 MICH. L. REV. 259, 296-99 (1966). For a more pointed antimanagementist view of the case, see Richard W. Jennings, *Trading in Corporate Control*, 44 CAL. L. REV. 1, 29-31 (1956) (arguing that a controlling shareholder who sells at a premium should forfeit that premium to the corporation). For a philosophical statement of the case, see David C. Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963).

The suggestion of a sharing rule has been vigorously contested. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 705-37 (1982). For a suggestion that the existing cases do an effective job of separating harmful and beneficial transfers, see Einer Elhauge, *The Triggering Function of Sale of Control Doctrine*, 59 U. CHI. L. REV. 1465 (1992).

60. The first case arises when the purchaser also solicits sales from other holders. The shareholder selling the control block breaches a duty if it makes no disclosure of its transaction because of the risk that it might attempt to persuade the other shareholders to sell on less advantageous terms. Proposed First Draft, *supra* note 1, § 5.16 cmt. d, at 506-07. This is the rule of *Brown v. Halbert*, 76 Cal. Rptr. 781 (1969), without dicta about equal opportunity. The second case arises if it is "apparent from the circumstances" that the purchaser is likely to violate a duty of fair dealing in such a way as to

The drafters follow precedent here.⁶¹ But in so doing, they align themselves on one side of a long-running academic dispute about the implications of the traditional fairness standard.⁶² This circumstance prompts the drafters to explain their normative choice, a rare event in their commentaries. The premium paid in these transactions, they say, might have multiple sources. The purchaser might intend to pay either for the opportunity to improve the company's management or for the opportunity to exploit the position purchased. The drafters presume in favor of improved management. They rely on a pair of empirical studies of control sales that show that the stock prices of the unsold minority blocks rise slightly following a sale.⁶³ They determine, in effect, that control sales do not injure nonparticipating shareholders and may enhance their investments.

This empirical position remains open to debate.⁶⁴ Given the countervailing policy of shareholder equality that pervades the code, one senses a need for a fuller explanation. Interestingly, the policy that fills the bill is a policy that the drafters disavow expressly: The encouragement of transactions in the market for corporate control.⁶⁵ That policy stems from efficiency considerations⁶⁶—considerations notably absent from the drafters' commentary in Part V.⁶⁷

obtain a significant financial benefit. Proposed Final Draft, *supra* note 1, § 5.16 cmt. e, at 509. This is, of course, a careful abstraction of the rule of *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955).

61. See, e.g., *Clagget v. Hutchison*, 583 F.2d 1259, 1262 (4th Cir. 1978); *Zetlin v. Hanson Holdings, Inc.*, 397 N.E.2d 387, 388-89 (N.Y. 1979).

62. See *supra* note 2.

63. Proposed Final Draft, *supra* note 1, § 5.16 cmt. c, at 504-06; *id.* reporter's note 1, at 513-15. The studies are Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. Bus. 345 (1980), and Clifford G. Holderness & Dennis P. Sheehan, *The Role of Majority Shareholders in Publicly Held Corporations*, 20 J. FIN. ECON. 317 (1988).

64. In showing that the stock of the noncontrolling shareholders does not decline in value around the time of the sale, the studies do not foreclose the possibility that the noncontrolling shareholders nevertheless bear an exploitation cost in connection with the sale.

65. Part VI, directed to transactions in control and tender offers, begins with the admonition that it reflects no "judgment on the economic, social and political issues posed by hostile takeovers." Proposed Final Draft, *supra* note 1, Part VI introductory note, at 517-23.

66. Under generally accepted theory, the threat of a hostile control transfer reduces agency costs by encouraging better management performance. The transfer transaction, moreover, moves the assets to a higher-valuing user, and—absent a controlling shareholder and given a competitive market—the shareholders participate pro rata in most of the value increase. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 171-74 (1991).

67. Corporate control policy also shapes a companion rule directed to management buyouts—transactions in which the corporation's managers purchase a control block from public shareholders either by a negotiated merger or by a tender offer. The code treats these transactions in the same manner as it does control-shareholder engagements. A safe harbor is available, but only if the management group gives the market an opportunity for free play respecting control of the corporation. This "market check"

C. *Opting Out*

The *Principles'* fiduciary standards, like those under present state law, are for the most part mandatory. The code explicitly constrains the power of individual corporations to vary the duty's terms and to promulgate their own less rigorous standards.⁶⁸ The drafters thus make a basic assumption that free contract does not operate in the world of corporate governance.

The code does accord corporations a limited freedom to promulgate their own "standards." These can specify self-dealing transactions, uses of property, or business opportunities, and provide advance permission for their undertaking by officers and directors.⁶⁹ Convenience is the stated rationale.⁷⁰ The drafters aspire to open a field for the easy synchronization of the legal governance model and the practice of the individual firm. But they remain protective of the legal model's integrity. A grant of advance permission should not imply abandonment of oversight by the board, say the drafters.⁷¹ Nor should individual firms be permitted to "dispense generally with or generally modify" the code's substantive and procedural rules.⁷²

involves the strictest procedural rules in Part V. Management must make public disclosure and must give interested parties relevant information and a reasonable opportunity to submit a competing proposal, and disinterested shareholders must ratify the transaction. In addition, disinterested directors must oversee the market offering process. *See id.* § 5.15 cmt. c(3), at 492-99.

The fairness standard here is the arm's length bargain, but in a stricter version. Garden-variety self-dealing transactions of directors and officers can qualify based on hypothetical reference to market transactions; the insider does not have to submit to the possibility of being outbid. Here, qualification of the transaction presupposes an actual opportunity for outside third parties to outbid the insider. *Id.* § 5.15 (b)(1). These strict standards presumably stem from recognition of the importance of management buyout transactions to the shareholder beneficiaries of the duty. The whole company, after all, is being sold. But this immediate shareholder interest in the highest price does not provide a complete explanation. Ordinary self-dealing transactions conceivably can have a very significant bearing on corporate performance and shareholder returns, but do not require a "market check." Moreover, in the case of insider sales of control—as opposed to insider purchases of control—the fact that control has gone onto the block does not give rise to enough concern about shareholder participation to cause the drafter to shape an aggressive fiduciary rule.

For a complete explanation, a policy favoring free play of the corporate control market and an attendant long-run vision of shareholder interest must be inferred. Management buyouts are transactions in that market, but are unlikely to realize maximum returns for shareholders. The management purchasers have a defensive incentive to initiate the transaction. They control its timing and have power to withhold information from potential competing bidders. To the extent they can exercise these powers with impunity, the scope and disciplinary effect of the market for corporate control diminishes. For discussion of the dangers of management buyouts, see generally Deborah DeMott, *Puzzles and Parables: Defining Good Faith in the MBO Context*, 25 WAKE FOREST L. REV. 15, 31-34 (1990) (providing examples of bad faith behavior of management during management buyouts), and Dale A. Oesterle & Jon R. Norberg, *Management Buyouts: Creating or Appropriating Shareholder Wealth?*, 41 VAND. L. REV. 207, 218-22 (1988) (describing potential for abuse in management buyouts).

68. Proposed Final Draft, *supra* note 1, § 5.09.

69. *Id.*

70. *Id.* § 5.09 cmt. a, at 423-24.

71. *Id.* § 5.09 cmt. c, at 424-30.

72. *Id.* § 5.09 cmt. d, at 430-35.

D. Summary

On one level, the code restates existing law. The drafters for the most part stay close to the existing body of case rulings. But they superimpose new structural principles on the law's existing pattern. The new principles send mixed normative signals. By institutionalizing disinterested-director approval, they make fiduciary regulation a matter of internal corporate governance. This adjustment implies that the values of business people will henceforth determine the content of "fairness," with dilutive substantive results. On another level, the drafters reject the proposition that contractual choice should prevail over the law's fiduciary norm in corporate contexts. They also raise shareholder-level fairness duties, once the exception in corporate law, to a status of equal dignity with director and officer duties. These steps imply that the meaning of "fairness" is still up to lawmakers to determine, and that stricter applications of the norm may be legitimate.

The rest of this Article identifies and resolves some of the tensions created by these mixed normative signals.

II. *Traditional Fiduciary Law, Corporate Governance Policy, and the Choices that Shape the Principles' Fiduciary Code*

The code's drafters make no sustained attempt either to explain why we have fiduciary duties or to justify their own formulations. They do not refer to efficiency considerations. They do not refer to a need for management disempowerment. Nor do they refer to an ethic of self-sacrifice or a similar value-laden concept. In general, they take fiduciary duty, and a constituent notion of justice as fairness, as given.

The drafters do make a few telling comments. Cumulated, these amount to a tender of a beginning of an explanation. An executive who takes the corporate jet on personal business should pay, they say, because shareholders have a "right to expect" payment of fair value.⁷³ This implies an assumption that "shareholder expectations" explain and justify corporate fiduciary law. Unfortunately, the drafters say nothing about their basis for assuming the empirical "expectations" on which the justification relies.

Elsewhere, the drafters tell us that the code's mandatory aspect is a consequence of "public policy." They observe that the shareholders cannot foresee the consequences of broad-brush waivers; therefore, their informed consent to them cannot be assumed.⁷⁴ Restating this point, the drafters assume that corporate governance

73. *Id.* § 5.04 cmt. d(3), at 368-74.

74. *Id.* § 5.09 cmt. d(2), at 433-35.

is not a field well-suited to free contract; therefore, "public policy" requires it to be regulated. Unfortunately, we are left to ourselves to determine the origins and content of this "public policy." We also are left on our own to apply the policy to support the particular regulations adopted by the drafters.

This part of this Article begins the job of filling in the explanation omitted by the drafters. First, it describes discussions about the nature and scope of fiduciary duty that went on in the background at the time the code was drafted. Second, it considers the code against this background and isolates the theoretical choices implicit in the drafters' work. These are, first, the choice of an open-ended description of the corporation, and, second, the choice of a mediative normative framework.

A. *The Loss of Confidence in Corporate Fiduciary Law*

The *Principles'* fiduciary code appears at the end of a period of dispute over the nature and justification of corporate fiduciary duties. This dispute addressed an old problem that inheres in all discussions of fiduciary law.

Fiduciary relationships present a problem of legal classification. They lie in a gray area between the more clearly defined worlds of government regulation and private ordering through contract. They plausibly can be characterized as a species of either. Because the fiduciary acts on another's behalf,⁷⁵ the relationship implies a beneficiary needing protective regulation. But fiduciary relationships also are volitional⁷⁶ and inevitably entail a measure of private ordering, in many cases a large measure. As a result, the same fiduciary relationship may be the subject of two sharply contrasting descriptions with contrasting normative implications. Depending on the factors emphasized, either legally mandated self-sacrifice or unconstrained pursuit of self-interest in an environment of free contract may be implied.

Disagreement over these choices pervades recent discussions of corporate fiduciary law. This academic story briefly can be retold.⁷⁷

1. *Traditional Fiduciary Law and Antimanagementist Corporate Policy*

Traditional fiduciary law favors beneficiary protection over fiduciary volition. The doctrinal literature asserts, plausibly enough, that a legal constraint against self-dealing is implicit in the structure of

75. See generally 1 AUSTIN W. SCOTT, *THE LAW OF TRUSTS* 43 (4th ed. 1987) (defining the fiduciary's role in terms of action for the benefit of another party as to matters within the relationship's scope).

76. The fiduciary accepts a power on condition that it be exercised in the beneficiary's interests. J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 *LAW Q. REV.* 51, 75 (1981). In the case of agency relationships, the acceptance ripens into express agreement. See *RESTATEMENT (SECOND) OF AGENCY* § 13 cmt. a (1958).

77. For a more detailed retelling, see William W. Bratton, *Self Interest and Good Will in Corporate Fiduciary Law* (Nov. 1992) (unpublished manuscript, on file with author).

fiduciary relationships. These relationships—characterized by action on another party's behalf and power in the acting party accompanied by dependence on the other's part⁷⁸—have qualitatively different premises than relationships in the world of private ordering.⁷⁹ Accordingly, classical contract law, which assumes pure self-interest on the part of contracting actors,⁸⁰ cannot provide an appropriate regulatory framework. The doctrinal result is a black-letter line separating contract from fiduciary law.

The traditional commentary justifies the imposition of the fiduciary's legal duty on two grounds. One is ethical—fiduciary exercise of power for self-interested reasons is wrong. The ethic can be stated positively or negatively. In the positive statement, the ethical fiduciary acts out of good will toward the beneficiary. In the negative statement, the ethical fiduciary abjures self-interested pursuits.⁸¹ The other justification is practical—the imposition of the duty facilitates productive relationships, whether of trust or of agency.

These traditional fiduciary principles present special problems when applied in corporate contexts. The basic relational fit is easy: The corporate manager takes the fiduciary role, exercising power that affects the interests of a dependent shareholder-beneficiary. The problem is that the fit is never perfect. In business situations, wealth creation can be as much a matter of entrepreneurial initiative as a matter of performance of a trust. Corporate relationships are driven by self-interest, present on all sides and known to all participants.

The corporate version of the duty of loyalty recognizes the possibility of legitimate, self-interested conduct by those in charge of corporations at the same time that it burdens them with a standard of self-sacrifice. To this end, it moderates the standard of selflessness upon the performance of qualifying procedures.⁸² The procedures, in theory, move the transaction out of the relational framework of power and dependence toward arm's-length dealing. The *Principles*,

78. See Shepherd, *supra* note 76, at 68-69; Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975).

79. The fact that many fiduciary relationships arise out of planned transactions does not obviate this point. Weinrib, *supra* note 78, at 3; see also Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 798 (1983) (stating that fiduciary relationships combine qualities of bargained-for contracts with a form of the power and dependence of status relations).

80. Restating the point in Macneillian terms, it enhances discreteness and presentation normatively. IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 59-64 (1980).

81. For an extended discussion of the traditional commentary, see generally Bratton, *supra* note 77.

82. The initial modification occurred at the turn of the century. See ROBERT C. CLARK, *CORPORATE LAW* 160-66 (1986); Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 36-40, 43 (1966). The *Principles* offer, in effect, a state-of-the-art presentation of the modified body of rules.

as we have seen, ratify and expand this approach, enhancing the legal effect accorded the judgment of the approving board.⁸³

This model of accommodation is a topic of continuing disagreement. Its supporters take the position that a stricter trust model of fiduciary duty makes no sense in business contexts and that this accommodation is a reasonable solution to a special regulatory problem. To the model's antimanagerialist detractors, contingent fiduciary duties are a part of a larger, unsatisfactory legal system of corporate governance.

The antimanagerialist attack proceeds as follows. Because public shareholders cannot as a practical matter control managers through the franchise, managers exercise their considerable power absent an adequate mechanism to assure accountability. Without an assurance of accountability, efficient production will not be achieved.⁸⁴ Relaxed fiduciary standards contribute to this governance problem. The system's procedures for qualifying self-interested managerial conduct are intrinsically ineffective because the managers control all internal decisionmaking processes in fact if not in name. Furthermore, investors expect a firm base of legal protection as a condition for parting with their capital. Strong fiduciary law supports this expectation, lowering the cost of capital and thus performing an efficiency function.⁸⁵

This antimanagerialist case for heightened corporate fiduciary regulation bears a family resemblance to the traditional doctrinal justification for all fiduciary duties. Both approaches lead to the same conclusion—that a strong conceptual barrier should be erected to separate fiduciary and ordinary contract relationships. But the overlap is not complete. The corporate case rests on a practical imperative—the need to protect investors. That imperative in turn depends on a particular picture of corporate power allocation and governance policy. The traditional story, in contrast, combines a similar practical imperative with an ethical justification for fiduciary self-sacrifice. The latter justification does not usually figure into these corporate discussions.⁸⁶

2. Corporate Law Under a Rational Expectations Paradigm

The introduction of a microeconomic model of the corporation in

83. See *supra* text accompanying notes 14-19.

84. This is the problem of the separation of ownership and control, identified in ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932), and discussed ever since.

85. See, e.g., Marvin A. Chirelstein, *Towards A Federal Fiduciary Standards Act*, 30 CLEV. ST. L. REV. 203, 218-19 (1981) (arguing that investors assume a high level of protection); David M. Phillips, *Managerial Misuse of Property: The Synthesizing Thread in Corporate Doctrine*, 32 RUTGERS L. REV. 184, 219-20 (1979) (stating that fulfilling expectations reduces costly uncertainty). See generally Bratton, *supra* note 77.

86. The custom is to dismiss fiduciary law's tendency to speak in moral terms as a rhetorical phenomenon. See Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 75 (John W. Pratt & Richard J. Zeckhauser eds., 1985). For a contrary approach, see Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1692-99 (1990).

the early 1980s countered the antimanagerial case for intensified fiduciary controls. The economic model discards the doctrinal distinction between contract and fiduciary relationships. It assumes that individual self-interest motivates all relationships, whatever their traditional legal classification.⁸⁷ Self-interested conduct, as a result, does not automatically prompt normative disapproval. All corporate actors become rational figures who take contractual steps to protect themselves. Thus modeled, shareholders do not necessarily expect strict legal protection under the fiduciary rubric. Instead, they primarily rely on competition in the market for corporate control and the market for executive skills to assure protection of their interests.

Under the economic model, fiduciary duties do not inhere in corporate relationships. Under its picture of universal contracting, no intrinsic need for legal regulation may be presumed. Legal duties can be justified only by showing that private actors given full information in a costless contracting environment would have agreed to them.⁸⁸ Fiduciary rules thus are reconstituted as contractual gap-fillers. By implication, they should yield to contrary agreement or "opting out" by the actors in a particular corporation.

This theoretical challenge to mandatory fiduciary duties was exhaustively discussed in the law reviews. In the end, the commentary confirmed the mandate's legitimacy. It was decided that process defects make the corporate charter amendment—the means to the end of opting out—an inappropriate context for complete freedom of contract, even when viewed through the lens of an economic model. Shareholders have a collective-action problem when managers propose charter amendments. Small stakes make it irrational for individual holders to invest in information acquisition.⁸⁹ Moreover, managers, by virtue of their control of the structure and timing of the amendment process, easily can turn the shareholder's inferior

87. This model caused an abrupt change in the political economics of corporate law during the 1980s. It tells the story of corporate organization in terms of the voluntary and purposeful interaction of rational free actors in a competitive environment. It was first articulated in Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 310 (1976). For the leading legal application, see EASTERBROOK & FISCHER, *supra* note 66. For a purer legal application of the model, see Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).

88. See, e.g., EASTERBROOK & FISCHER, *supra* note 66, at 15; Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1550-51 (1989). The reconception of corporate relationships in terms of microeconomic agency relationships causes many of the injuries recognized by corporate and securities law to disappear. See, e.g., Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 10-11 (1984).

89. See, e.g., John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 933-35 (1988); Gordon, *supra* note 88, at 1575-77.

negotiating position to advantage.⁹⁰ The result is a contract failure: The shareholders rationally vote to approve an amendment that is value decreasing to them. Accordingly, broad-brush abolitions of fiduciary duties by charter amendments sometimes should be subject to mandatory regulation even under a microeconomic paradigm.⁹¹ As noted above, the drafters of the *Principles* draw on this rationale to justify the code's constraint on opting out.⁹²

The microeconomic model of corporate law thus failed to accomplish a deregulatory policy mission. But its methodology did succeed in becoming the ordinary framework for evaluating corporate law problems. The academic ratification of mandatory fiduciary duty was articulated in a rational-expectations format. Traditional notions of power, dependence, and ethical constraint did not figure into the discussion.

Fiduciary law emerged from this debate in a weakened theoretical posture.⁹³ Although few scholars today view corporate governance as a matter of contract success, most nevertheless view it as a species of contracting problem. Legal intervention, in turn, has come to be viewed as a less than satisfactory solution. From a rational-expectations point of view, the shareholder plaintiff in an action for breach of fiduciary duty is every bit as much an opportunist as the management defendant.⁹⁴ Moreover, the "shareholder expectations" that once justified legal intervention now look much different. The efficient market hypothesis and the capital asset pricing model highlight pathways for partial shareholder self-protection;⁹⁵ shareholders who can protect themselves to some extent presumably "expect" less in the way of legal protection.⁹⁶ In addition, the

90. Gordon, *supra* note 88, at 1577-84. Professor Coffee stressed this problem of "agenda manipulation" over the rational apathy story. He pointed out that shareholders easily can just say no, but that management's ability to manipulate the agenda stunts the whole corporate contracting process. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1674-75 & n.234 (1989).

91. Under the consensus view, the amendment process is deemed reliable for amendments that are company-specific and transaction-specific—for example, poison pills or stock option plans. But for general, open-ended proposals—for example, broad-brush abolition of director and officer fiduciary duties—contract failure is probable. See Coffee, *supra* note 90, at 1664-65; Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1469-70 (1989); Gordon, *supra* note 88, at 1593-97; Robert B. Thompson, *The Law's Limits on Contracts in a Corporation*, 15 J. CORP. L. 377, 388 (1990).

92. See *supra* text accompanying note 74.

93. For a recent inspection of the whole body of fiduciary law from a rational-expectations perspective, see Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991).

94. See EASTERBROOK & FISCHEL, *supra* note 66, at 99-100; Jason S. Johnston, *Opting In and Opting Out: Bargaining for Fiduciary Duties in Cooperative Ventures*, 70 WASH. U. L.Q. 291, 312-320 (1992).

95. For discussion of these theories and their limitations as a basis for normative decisions, see Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851 (1992).

96. The capital asset pricing model asserts that, because investors can diversify unsystematic risk from their portfolios, they only will be rewarded for bearing market risk. See VICTOR BRUDNEY & WILLIAM W. BRATTON, BRUDNEY AND CHIRELSTEIN'S CASES AND MATERIALS ON CORPORATE FINANCE 98-112 (4th ed. 1993). The inference arises that investors can protect themselves from breaches of fiduciary duty; because management

proportion of institutional shareholding has increased, and some institutional representatives have become active and even intermittently effective in corporate governance. Shareholders consequently appear less and less well-suited to the victim's role. It no longer seems safe to assume that mandatory self-abnegation among managers promotes investor confidence and lowers the cost of capital. The idea of investor protection, which formerly served as the justification for introducing traditional values of fiduciary law into corporate governance discussions, now carries little weight as a policy imperative.

The economic critique also increased sensitivity to the costs of enforcing fiduciary duties. The direct costs of litigation constitute only a part of this problem. Questions also arise about the institutional competence of courts. Although courts apply the business judgment rule to limit inquiry into investment and management decisionmaking,⁹⁷ conflicts of interest for the most part have been held to lie outside of the forbidden territory. Lately, however, academics have come to view conflict-of-interest problems as economic puzzles for technical solution.⁹⁸ The litigation process is an intrinsically suboptimal mode for working through to the solution of problems thus characterized.

In sum, the prevailing disposition is to read the inherited body of corporate fiduciary law narrowly and to presume that any expansion of its reach is prohibitively costly absent a clear contrary showing.⁹⁹

self-dealing is an unsystematic risk, it can be diversified out. See EASTERBROOK & FISCHER, *supra* note 66, at 122-124.

97. See Proposed Final Draft, *supra* note 1, § 4.01; *id.* § 4.01(c) cmt., at 227-44; *id.* reporter's note 2, at 245.

98. See, e.g., Johnston, *supra* note 94, at 312 (outlining possible "game" stages).

99. For notably narrow recent readings, see, for example, EASTERBROOK & FISCHER, *supra* note 66, at 90-108, and Johnston, *supra* note 94, at 310-11 (describing the likelihood that expansive courts might reward baseless claims). Corporate governance commentators have given up on the prospect of effective market controls of management to grapple anew with the old problem of management accountability. Ten or fifteen years ago, commentaries dealing with accountability problems often recommended revised fiduciary rules as a solution. See, e.g., Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 313-25 (arguing that gains from parent subsidiary mergers should be divided equally as a percentage of premerger values); Brudney & Clark, *supra* note 56, at 1022-42 (recommending categorical prohibition of full-time executives of public corporations from taking other business opportunities). Today, the governance debate focuses on self-help by institutional investors rather than direct legal control under the fiduciary rubric. See, e.g., Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990) (setting forth economic analysis showing that institutional-investor involvement is cost effective); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1355-57 (1991) (arguing for legal reforms designed to encourage institutional-investor participation in corporate governance); Ronald J. Gilson & Reiner Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 905 (1991) (urging voluntary monitoring organization). It should be noted that

B. *Theoretical Implications of the Principles' Fiduciary Code*

1. *The Avoidance of Political and Economic Theory*

The *Principles* are not offered as a "restatement" of corporate law. Indeed, corporate law's inherited structure causes many of the governance problems to which they are addressed. They accordingly recommend changes in the legal model of governance structure. These changes center on a monitoring model of board responsibility and a practice of nominating a majority of outside directors.¹⁰⁰ The drafters hope that these devices will cure the governance problem cooperatively, without full-scale government intervention. In the drafters' projection, outside directors will monitor actively and thereby prevent the worst excesses of management empowerment. The realization of their reform aspirations depends on this projection's accuracy.¹⁰¹

The effectiveness of the *Principles'* fiduciary code also depends on this projection's accuracy. The monitoring model's reliance on the outside director parallels the fiduciary code's empowerment of the disinterested director. This is the primary conceptual link between the *Principles'* structural and fiduciary parts.

If we put this link to one side and consider the fiduciary code in isolation, it quickly takes on many of the properties of a restatement. It mostly ratifies the results of the decided cases and purveys fiduciary law as a closed legal system. It is composed of "principles," but not principles rationally derived from a stated body of policy assumptions, whether political or economic in character. Indeed, the drafters avoid references to political and economic paradigms of corporate production.¹⁰² Their commentaries instead stay very much in a traditional mold and refer randomly to the cumulation of present legislation, to past judicial precedent, and to corporate practice.

This positivist methodology works well for a project that purports only to restate the law, but it goes against the grain of prevailing academic standards respecting the articulation of legal "principles." Most observers today assume that a body of legal principles cannot be understood or justified adequately as a closed system that makes reference only to its own stated premises.¹⁰³ The habit is to support

practical reasons support this; rules against self-dealing do not tend to address directly the problem of ineffective management.

A contrary position in favor of fiduciary litigation as a governance tool is in the early stages of articulation. See William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 Nw. U. L. REV. 180, 205-08 (1992); Charles M. Yablon, *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 COLUM. L. REV. 1867, 1867-70 (1992) (reviewing GRAEF CRYSTAL, *IN SEARCH OF EXCESS* (1991)) (arguing that corporate law should play a larger role in curtailing outrageous executive compensation arrangements).

100. See, e.g., Proposed Final Draft, *supra* note 1, §§ 3.02, 3A.01.

101. See *supra* notes 14-26 and accompanying text.

102. See *supra* text accompanying note 73.

103. Cf. Richard A. Posner, *The Present Situation in Legal Scholarship*, 90 YALE L.J. 1113 (1981) (dividing legal scholarship into three categories—doctrinal analysis, social science analysis, and normative analysis—and warning that doctrinal analysis is currently endangered in the law schools). Today, academic treatments of corporate law tend to

legal structures by reaching to outside economic, political, and social imperatives. That habit by now is so deeply ingrained that the *Principles* become noteworthy for their limited frame of reference. Further explanation and justification are appropriate.

Some reasons for the limitation suggest themselves. First, the *Principles*, as an ALI project, are directed primarily to legal decision makers.¹⁰⁴ They import action in the world of practice rather than explanation at the level of theory. In our polity, ideological trappings make a plan of action less plausible. The drafters' methodological restraint thus follows from the seriousness with which they take their self-declared role.

Second, reference to outside political and economic frameworks would be an awkward exercise for the drafters of this particular code. Their product offers little to satisfy theorists of the corporation, whether proponents of the microeconomic corporation or antimanagerialists.

Consider first economic theories of the firm. They influence the code here and there. The drafters limit remedies carefully to discourage speculative litigation;¹⁰⁵ the policy of protecting the market for corporate control shows its hand.¹⁰⁶ But the code on the whole proceeds without regard to the economic theory of the firm. It unquestioningly accepts an undefined fairness principle as a limit on contractual innovation in corporate governance. And it reaches out to chill entrepreneurship with its strict constraints on insider trading, corporate opportunities, and the privileges of controlling shareholders.

Now consider the antimanagerialist frame of reference. The *Principles*, by recommending alterations in the legal model of corporate structure, implicitly share the antimanagerialists' concern about corporate accountability. But antimanagerialists will question the law-making role that the fiduciary code accords to the disinterested director. It is one thing to suggest structural modifications of governance processes in the hope that outside directors will prove to be effective. It is another thing to recommend present changes in the system of substantive controls provided by fiduciary law based on the same hope. The drafters identify no concrete basis to support the conclusion that board level, conflict-resolution processes adequately protect investor interests. The antimanagerialist thus

evaluate law as a means to the end of wealth maximization and look beyond legal sources to economic analysis for guidance on particular maximization strategies.

104. Segments of the code carry a recommendation respecting implementation by judges or legislatures. See, e.g., Proposed Final Draft, *supra* note 1, § 4.01 cmt. b, at 184; *id.* § 5.02 cmt. b, at 281.

105. See *supra* notes 26 and 35.

106. See *supra* text accompanying notes 65-67.

should conclude that the disinterested-director barrier to fairness review serves to complete a century-long process of eviscerating the corporate duty of loyalty.¹⁰⁷

2. *The Implicit Description*

The drafters solve no problems by choosing a traditional mode of explanation and avoiding mention of current theories of the firm. Hard descriptive and normative choices inherent in discussions of fiduciary law do not disappear conveniently with the choice of a doctrinal framework of inquiry. The drafters of this code make some of these choices and defer others. In both cases they refrain from discussing their choices explicitly.

Let us review their descriptive choices and fill in some of this discussion. They begin the code by announcing a contractual description: The duty at issue is one of “fair dealing,” not “loyalty.”¹⁰⁸ This at first looks like a foundational decision to emphasize the contractual aspects of corporate relationships. But it turns out to lack powerful descriptive implications because the code does not reconstruct situations of power and dependence as situations of arm’s-length bargaining.

Thus, despite the new title, the drafters’ corporation is not contractual in an economic or doctrinal sense. What then is the operative description of the firm? The code’s uneasy combination of mandate and accommodation presupposes a description of corporate relationships that includes both legitimate pursuit of self-interest and necessary pursuit of the welfare of others. In this view, corporations straddle the black-letter line that separates the traditional doctrinal descriptions of fiduciary and contract relationships. The choice, as it were, is to be open-ended about descriptive choices. No reductive vision of the corporation blocks consideration of all the particulars of a matter under the code.

It should be noted that the code follows the lead of the microeconomic description of the corporation in disregarding corporate doctrine’s categorical descriptions. But the resemblance is incidental. The code’s drafters have not interposed a rational-expectations description of the corporation. Instead they implicitly assume that a complex set of values figures into corporate behavior and that tensions will arise between self-interest and self-abnegation. They leave these tensions for situational resolution based on more particular descriptions. To facilitate these decisions, they install channels of communication between legal decisionmakers and regulated actors.¹⁰⁹ The code’s underlying description thus does not imply deregulation. Indeed, in at least one instance, it could open a path to increased scrutiny. As we have seen, the code collapses the shareholder-level fiduciary duty into the directors’ and

107. See Marsh, *supra* note 82 (detailing the history of the duty of loyalty in the last century).

108. See *supra* text accompanying note 11.

109. See *infra* text accompanying notes 119-20.

officers' duty, and thereby negates a long-standing doctrinal distinction that discouraged judicial intervention.¹¹⁰

This invitation to stepped-up scrutiny, however, stands alone in the code. In the main, the drafters avoid asserting facts or shaping rules that point the law in the direction of significantly intensified fiduciary norms. The complex set of values in their description discourages the isolation of categories of self-interested conduct for per se prescription.¹¹¹ The description thus distances the code from the antimanagerialist approach to fiduciary duty.¹¹²

3. *Implicit Norms*

Although the code's drafters address and reject the microeconomic norm of free contract,¹¹³ they make no sustained attempt to address the antimanagerialist case against their self-regulatory model. We can, however, draw on the drafters' comments about the purpose of their enterprise to construct such a rebuttal. This exercise begins the task of explaining and justifying the code's normative profile.

The drafters emphasize that fairness is not an absolute, unchanging concept, but an evolving one.¹¹⁴ A particular determination of "fairness" is a situational proposition;¹¹⁵ internal corporate procedures are aspects of the situation thus reviewed. Furthermore, the fairness norm does not evolve solely as a matter of the reaction of legal decisionmakers to business events. Business practice bears critically on the norm's articulation.¹¹⁶ In the end, "fairness" gains substance as the result of a collaboration between legal decisionmakers and business people.¹¹⁷

110. The doctrine consigned shareholder-to-shareholder interrelations to a contractual world of self-interested pursuits. See *infra* notes 166-61 and accompanying text.

111. This description instead supports the across-the-board inclusion of corporate decisionmaking into the legal process that we find in the code. See *supra* text accompanying note 17.

112. The implicit description, while neither microeconomic nor antimanagerialist, does share significant assumptions with the relational model of contract law. The reference here is to the model of Macneil, see MACNEIL, *supra* note 80, rather than to the microeconomic version set out by Williamson and others. See, e.g., OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985). Part III of this Article applies the relational model to corporate fiduciary law.

113. They do this in connection with their discussion of opting out. See *supra* text accompanying note 68.

114. See Proposed Final Draft, *supra* note 1, Part V introductory note a, at 263-64.

115. Cf. *id.* § 5.01 cmt. c, at 271-72 (stating that the "full meaning" of fair dealing is context-dependent).

116. Cf. *id.* § 5.02(a)(2)(B) cmt., at 292-300 (referring to business practice as a justification for subjecting self-dealing transactions approved by disinterested directors to any scrutiny at all).

117. Thus the drafters defend their fairness standard by reference to a practice document—the *Corporate Director's Guidebook*, Subcommittee on Functions and Responsibilities

The code's provision for relaxed judicial scrutiny upon disinterested board-level approval facilitates this process.¹¹⁸ The provision induces corporations to take the law's fiduciary norms into account in the conduct of their business. It keeps business practice attuned to the norms of fiduciary law by vesting the directors with legal responsibility. At the same time, by providing for directorial input at the threshold level, it keeps fiduciary law attuned to the values of its constituents.

The code, then, avoids imposing a behavioral blueprint on corporate actors, and instead offers them a process designed to elicit behavioral norms that take their values into account. Its drafters thus make a normative choice to privilege mediation over prohibition by rule. The implicit assumption is that corporate law's normative agenda should be carefully delimited; it should attempt to determine neither the course of production nor the shape of production relationships.

It bears noting that this endorsement, rationalization, and expansion of the law's existing self-regulatory model of corporate conflict-of-interest resolution is not a deregulatory program. The code induces corporate actors to participate in a lawmaking system with carrots and sticks. If they do not participate, then the system subjects their behavior to traditional constraints. If they do participate, then they must follow certain procedures if their internal decisions respecting conflicts of interest are to attain the force of law. Furthermore, even where correct procedural forms are followed, the code leaves a substantive limit in the background, a limit rooted in the inherited body of law and built around the notion of the best interests of the entity. The code thereby declines to open a door to complete substantive self-determination by those in control of corporations. Its mandatory, albeit diluted, fairness standard leaves open the constant possibility that the final decision will not be left with corporate managers.¹¹⁹ This possibility assures that input from legal professionals, and through them, society as a whole, will continue to influence the development of fiduciary law.

of Directors, ABA, *Corporate Director's Guidebook*, 32 BUS. LAW. 5 (1976). *Id.* § 5.01 reporter's note 2, at 273-74; see also *id.* § 5.02(a)(2)(B) cmt., at 292-300 (referring to NEW YORK STOCK EXCHANGE, INC., NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL (1990) and corporate codes of conduct).

118. Under the code's standard of review, literally applied, judicial lawmaking in this area operates on a factual and normative base supplied by the business people being regulated. The reviewing court must find the transaction to be "clearly outside the range of reasonableness." *Id.* § 5.02(a)(2)(B) cmt., at 292-300. This gives the approving directors initial input on the boundaries of the "range of reasonableness." To the extent that the transaction must be "clearly" outside of that range in order to be held violative of the duty, the approving directors also are accorded a degree of discretion in fixing those boundaries. Finally, the determination of fair and unfair transactions within the range is entirely left up to the directors.

119. The code is a regime of "reflexive" law in that it "requires the legal system to view itself as a system-in-an-environment . . . and to take account of the limits of its own capacity as it attempts to regulate the functions and performances of other social subsystems." Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 LAW & SOC'Y REV. 239, 255 (1983). But it is reflexive only to an extent; the final decision is not always the province of the regulated entity.

The code thus uses the mandate of fairness to force corporate managers to mediate with other actors interested in the corporation and in society in respect of self-dealing transactions.¹²⁰ It succeeds no better than prior law in purveying the fairness mandate in an objective, self-executing form. But it does ameliorate the problem of vagueness by providing a framework for the mandate's future application in which input from business people matters.

The code, by encouraging mediation between the self-interest of the actors controlling the corporation and the interests of other corporate actors, necessarily also mediates at a theoretical level. Its implicit political theory of the firm is open-ended. Under the code, the state and its decision makers retain final power to determine the law's terms. But this confirmation of the sovereign's primacy in corporate lawmaking does not imply that the corporation is a state instrument that exercises delegated state authority.¹²¹ The code leaves too large a place for private participation for the image of the state instrumentality to make sense. At the same time, the code avoids treating the corporation as another species of private contract. Its corporation is a private contract with public implications, suited to continued application of an inherited body of controls derived through the legal system.

C. Summary

The *Principles'* code, with the corporate law it restates, takes the political middle ground. It avoids references to prevailing theories of corporate law that tend to privilege one aspect of the corporation's broader politics and economics at another's expense. And where it reshapes—as opposed to restates—the law, the code focuses on process over mandatory substance, whether regulatory or deregulatory. It offers a system designed for the resolution of the future's difficult questions rather than a set of directions that resolve those difficult questions for us.

120. The best substantiation of the *Principles'* mediative approach is their most politically sensitive discussion—that on the purpose of the corporation. See Proposed Final Draft, *supra* note 1, § 2.01 (stating that the corporation's purpose may focus on ethical and philanthropic considerations); *id.* § 2.01 cmt. h, at 80-82; *id.* § 2.01 cmt. i, at 82-89 (setting forth ethical considerations and philanthropic purposes).

121. On this concession theory, compare Robert Hessen, *A New Concept of Corporations: A Contractual and Private Property Model*, 30 HASTINGS L.J. 1327, 1327-28 (1979) (stating that the "importance of the corporate concession theory can hardly be overstated"), with William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 433-36 (1989) (arguing that the concession theory has lost its vitality).

III. *Restoring Confidence in Corporate Fiduciary Law—A Relational Perspective*

The foregoing discussion puts a positive gloss on the *Principles'* fiduciary code. It explains the drafters' choices in terms of a cooperative vision of corporate regulation. But it does not foreclose the possibility of explaining some of these choices in other, less positive terms. The code's descriptive and normative flexibility still plausibly can be read from a negative, antimanAGERIALIST perspective. Under this reading, the code creates opportunities to dilute fiduciary constraints and thus manifests the wider decline of confidence in fiduciary regulation. Its empowerment of the disinterested director is nonproblematic only presupposing a judgment that unmitigated application of traditional doctrine leads to wrong answers and unjustified costs. With that judgment comes the hope that business people, once invested with responsibility, will rise to the occasion and prove capable of statesmanship. Attractive though this aspiration may be, it seems safe to predict that many business people will fail to live up to it.

Indeed, weaknesses in the case for expanded self-regulation of conflict of interest transactions are apparent even without resort to an antimanAGERIALIST point of view. Self-regulation tends to work well in institutional contexts where different actors with diverging interests play on a common regulated field in a situation of interdependence and balanced power. Differing interests, when coupled with interdependence, give the actors incentives to monitor one another and enforce legal norms.¹²² Successful self-regulation also tends to require that independent, professionally motivated actors from inside the industry be designated to perform technical regulatory functions.¹²³

Corporate boardrooms populated with outside directors appear at first glance to have these characteristics. Because the outside directors' immediate financial interests lie with other firms, their personal reputational interests supposedly assure that the managers' self-interested proposals receive a skeptical and scrupulous reception; technical problems concerning value are referred to outside, supposedly neutral experts from the investment banking community. The premise that a principle affiliation to a different firm assures a director's independence is weak. As often has been noted, the high ranking executives of other firms who tend to be appointed as outside directors display a pattern of community of interest with

122. See David P. McCaffrey & Sue R. Faerman, Shared Regulation in the United States Securities Industry 21-23 (Feb. 1993) (unpublished manuscript, on file with author); cf. Ian Ayres & John Braithwaite, *Tripartism: Regulatory Capture and Empowerment*, 16 LAW & SOC. INQUIRY 435, 436-445 (1991) (suggesting that the problem of capture of regulatory agencies by regulated actors can be ameliorated by the empowerment of nongovernment organizations interested in effective regulation).

123. McCaffrey & Faerman, *supra* note 122, at 23-25 (noting strong ties between securities industry compliance officers and the SEC).

inside directors and officers.¹²⁴ They do not necessarily have interests sufficiently at variance with the managers' interests to assure effective monitoring. Furthermore, the technicians drawn on in board room conflict of interest situations—investment bankers who render the valuation opinions on which boards base fairness determinations—compete with one another for the business of providing this and other services. These actors have not been noted for their independence of judgment.¹²⁵

These doubts about the effectiveness of the code's self-regulatory scheme support the charge that it restates fiduciary law only to turn it over to corporate actors to be destroyed.¹²⁶ The code's drafters make few efforts to anticipate or rebut the charge.¹²⁷ Indeed, they invite it. Consider their change of the duty's name to "fair dealing." Despite their technical explanation,¹²⁸ the new contractual name rhetorically cuts the code off from its roots in traditional fiduciary concepts. It suggests a tie to the "no confidence" view of fiduciary regulation; both the lack of confidence and the idea that corporate law should be articulated in a contractual framework follow from a common set of assumptions. This contractual reference, taken together with the code's limit on review of disinterested-director decisions, suggests not self-regulation, but deregulation.

The last part of this Article seeks to make a case for a more positive reading of the code—a reading that stresses the "regulatory"

124. See Victor Brudney, *The Independent Direction—Heavenly City or Potemkin Village*, 95 HARV. L. REV. 597, 609-612 (1982) (describing the "institutionally generated disinclination to hold colleagues at arm's length"); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 99-108 (1985) (reviewing interpersonal familiarity and boardroom bias).

The *Principles'* definition of "significant relationship," which separates independent from inside directors, see Proposed Final Draft, *supra* note 1, § 1.34, does not distinguish directors who identify with management's point of view from those who identify with the point of view of investors.

If the institutional investor activism of recent years, see *infra* notes 148-50 and accompanying text, becomes institutionalized, then the boardroom may become a more suitable venue for self-regulation. Board members who identify themselves with investors' perspectives could prove to be vigorous monitors in conflict-of-interest situations.

125. See Lucian A. Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27, 53 (stating that investment banks face conflicts of interest that lead them to use their discretion to render fairness opinions in management's favor); see also Ted J. Fiflis, *Responsibility of Investment Bankers to Shareholders*, 70 WASH. U. L.Q. 497 (1992) (recommending gatekeeper liability for negligent fairness opinions).

126. This debate will have a familiar sound to veterans of corporate governance discussions. The antimanagerialist realist emphasizes managerial cupidity and power pursuit. The opposite side responds with an aspirational notion of managers as statesmen. See Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276, 1297-98 (1984) (critiquing both models of corporate analysis).

127. One can do little more than point to instances where the code intensifies the present or potential strength of the traditional fairness standard. See *supra* Part I.B.2.

128. See *supra* text accompanying note 12.

aspect of “self-regulation.” It makes two points toward this end. First, the substantive law that the code restates already possesses the responsiveness to the values of business actors that the code seeks to institutionalize through self-regulation. Mediation long has been intrinsic to the structure of corporate law. Second, the law’s responsiveness, once highlighted, bolsters confidence in its normative mission. Traditional fiduciary concepts, properly understood, do not lead to wrong answers in contemporary corporate situations. We can address all the policy concerns that have prompted the recent academic movement away from fiduciary solutions and at the same time continue to make reference to traditional doctrinal notions. Corporate law can respond to economic imperatives even as it incorporates conventional notions of relational power and dependence and aspirations of good will and self-sacrifice among fiduciaries.

These points come forward when corporate law’s recent evolution is viewed from a relational perspective. The relational model assumes that actors make self-interested choices based on personal preferences and at the same time subscribe to norms that take some alternatives outside of the realm of free choice. Corporate law makes the same assumptions: its fairness mandate presupposes that self-serving corporate actors also subscribe to a norm of self-sacrifice. The norm’s presence in the law implies an assertion that corporate actors continue to subscribe to the norm. The assertion does not exclude the possibility that actors could abandon the norm in the future and move the bulk of conflict of interest determinations to the realm of preferential choice; but the burden lies on the party claiming that abandonment has occurred.

The discussion that follows repeats the assertion that the norm operates, but with a caveat. In recent years, corporate institutions have evolved so as to expand the zone of preferential choice. A combination of factors—increased security holding through intermediaries, open trade in corporate control, and expanded opportunities for exit through securitization—significantly increases opportunities for treating corporate relationships as arm’s-length exchanges. Because actors who turn to arm’s-length bargaining tend to cease to rely on norms of self-sacrifice, the application of fiduciary norms must be adjusted. But, because none of these developments completely expunges norms of self-sacrifice from the corporate scene, they do not imply the elimination of fiduciary norms. Corporate production continues to require too much long-term interdependence among the actors involved to be amenable to organizational structures that dispense with cooperative norms. Investors still put themselves into a situation of dependence when they transfer capital to legal entities under the control of parties with different interests. Thus, aspirational standards of good will and self-sacrifice continue to influence the legal model of corporate

relationships, despite changing business practices.¹²⁹

It follows that modifications of the traditional doctrinal fiduciary construct—such as those set out in the *Principles*' fiduciary code—neither follow from nor support the proposition that corporate fiduciary law should be reconceived as an arm of contract law that backstops the arm's-length exchanges of corporate actors. The rigid doctrinal concepts of earlier eras have disappeared from the law because of developments in the ordinary course of business practice, not because of some growing realization that a single contractual essential lies at the core of corporate production. As this Part's discussion will show, contract law principles do bear a family resemblance to those applied in corporate contexts. Their meaning, however, is contextually bounded by contract law's relational framework. Translated to corporate contexts, they have limited heuristic power.

The *Principles*' fiduciary code thus legitimately draws on the same aspirations that inform antecedent fiduciary law. The fiduciary concepts it restates are a necessary and vital part of the legal model of corporate governance. Its self-regulatory structure should open channels of communication respecting the meaning of these principles, but need not and should not enervate them. Under this view, the contractual title chosen by the drafters carries no interpretive weight. Furthermore, disinterested-director participation should be treated as lawmaking rather than as contracting. The code, as it were, invites the board to apply the law rather than to avoid it.

A. *The Relational Properties of Corporate Fiduciary Law*

Traditional doctrine holds that fiduciary duties differ in kind from contractual duties.¹³⁰ This proposition is responsible for a great deal of misunderstanding. Under the "no confidence" view, it is thought to import a corporate fiduciary system that imposes trust concepts on agency situations with wealth-depressive results. But this much-discussed threat of inappropriate application of fiduciary principles is more apparent than real. We can dispel it by drawing on a relational theory of private law to modify the distinction between fiduciary and contract.

129. Cf. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 573-74 (1990) (arguing that culture and extralegal norms of proper behavior play an important part in managerial self-restraint).

130. See *supra* text accompanying notes 78-81.

1. Corporate Doctrine Without an Essential Fiduciary Duty

Under relationalism, all private interactions fall into the same capacious legal category.¹³¹ Legal duties follow from the context and incidents of the particular relationship. A notion of the “fiduciary” survives as a characterization applicable in certain intertwined situations in the wider world of voluntary relationships. A contrasting notion of “discrete contract” also survives. The discrete contract lies at one end of the relational continuum; intertwined, enduring relationships, including many trust relationships, lie at the other. Different relationships can be identified as having different “discrete” or “relational” elements and different “contractual” or “fiduciary” elements; many relationships combine both elements of both pairs.

Relational inspection thus breaks the doctrinal categories. But it does not thereby undercut legal fiduciary duties. Mandatory imposition easily can be reconfirmed from a relational perspective. The sovereign plays a role in every relationship. It enforces the discrete contract, but otherwise is little involved with it. With relationships of empowerment and dependence, government intervention is more likely to become a part of the relationship’s fabric. At some point, sufficient responsibility is reposed in one party to prompt not only legal duty, but nonwaivability of that duty.¹³² At the same time, some situations deemed “essentially” fiduciary under the doctrine come up for relational scrutiny because of their contractual aspects. Questions are particularly pertinent in respect to relationships, such as corporate relationships, midway along the continuum. The removal of the differentiating essence makes the actors and their practices more prominent as normative determinants of legal duties. In the relational picture, the duties follow from the parties’ values rather than from the sovereign. In this framework of relational contingency, corporate fiduciary law becomes more cognizant of corporate practice and the values of corporate actors. Changes in the practice thus should affect the law. For example, if shareholder expectations change from long-term to short-term, and from reliant to self-protective, then the intensity of the fiduciary duties that protect them should change correspondingly.¹³³

Even absent changes in practice, the relational perspective raises questions about the status of legal duties once universally assumed to be mandatory. If the “essential” fiduciary element is removed, it

131. There are two variants of relational contract theory, open and closed. The open variant admits social and political values in addition to economic values. The closed variant is limited by the frameworks of microeconomics. Macneil is the primary “open” writer. See, e.g., MACNEIL, *supra* note 80, at 78-84. On corporate topics, see also Alison G. Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. REV. 738, 776-78 (1978). Williamson is the primary closed writer. See WILLIAMSON, *supra* note 112, at 298-302; see also Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1095-1111 (1981). The “relationalism” referred to in the text of this Article is the open variant.

132. See Anderson, *supra* note 131, at 759-61.

133. See *infra* notes 138-50 and accompanying text for a description of recent changes.

becomes plausible to recharacterize corporate relationships in contractual terms. Moreover, if the relational description includes an effective waiver of legal protection by the beneficiary, the transformation to contract status becomes complete. A knowing waiver revokes the trust on which the fiduciary characterization rests. The waiver shows that the parties themselves treat the relationship contractually. Arguably, respect for the parties' choice counsels that the legal characterization follow suit. Under this analysis, nothing in corporate relationships can be "essentially" fiduciary as long as practical possibilities for waiver present themselves. It stands to reason that the recent debate over the mandatory aspect of corporate fiduciary law devolved on all sides to a technical discussion about standards for effective consent.¹³⁴

But making the fiduciary aspect of corporate law contingent rather than essential does not imply that a foundational "corporate contract" lies beneath the surface ready to substitute for the old fiduciary model of the corporation. The fact that, analytically, the fiduciary can yield to contrary agreement does not prove that contrary agreements have been or could be entered into. In public corporations, for example, no one seems to "know" as an empirical proposition what degree of legal protection the parties really "prefer." The parties might not even know themselves—thus leaving their ultimate preferences open to suggestion. It follows that questions about the effectiveness of consent to alternative contractual arrangements need to be asked on an ongoing basis. Answers will tend to depend on the model of consenting actor applied by the commentator. The more disabled the actor becomes at self-protection, whether because of cognitive failings or erratic behavior patterns, the more appropriate mandatory fiduciary duties will prove to be.

2. *Business Practice and Corporate Fiduciary Law Under a Relational Approach*

Signals from actors in practice bear critically on the law's normative substance under a relational approach, just as they do under a microeconomic model of the corporation. But the two approaches construct the corporate actor differently and thus hypothesize different sets of signals. The microeconomic model assumes complete self-interest while the relational model does not. The two models therefore must treat the corporation differently to the extent that, in practice, actors in corporate relationships treat one another with good will and practice the self-abnegation described in the doctrinal

134. See, e.g., EASTERBROOK & FISCHER, *supra* note 66, at 32-34; Gordon, *supra* note 88, at 1575-77.

picture of the fiduciary relationship. Under a relational view, if good will underlies the relationship, then a legal regime built on the self-interest model improperly disregards constitutive values. Such a constitutive business ethic, once imposed in law, is not imposed solely as sovereign dictate. It is self-imposed, albeit indirectly, by corporate actors.¹³⁵

Under a relational approach, the traditional fiduciary ethic could be eliminated from corporate law. But doing so would require an empirical model of the corporation working along the lines described by Jensen and Meckling in their famous article;¹³⁶ actors on all sides would have to engage in relationships conceived and executed as discrete contracts. In such a corporation, fiduciary duties could not be imposed under either a relational or microeconomic perspective. With arm's-length relationships and no external injuries, the state that mandated fiduciary norms would fail to respect the actors' autonomy and values in favor of recognizing values from some other source. Moreover, because the price terms of these discrete contracts would allocate the risk of opportunism, ex post judicial intervention might precipitate an uncompensated wealth transfer to an opportunistic claimant. In contrast, where good will suffuses the relationship, intervention to constrain opportunism recognizes the relational roles of the actors. As with any legitimate contract enforcement, the ex post constraint on the actors' freedom has a legitimating antecedent in their own conduct.

The Jensen and Meckling model does not describe fairly today's public corporation. Even so, some corporate relationships, particularly those between investors and management, have taken on a more discrete aspect in recent history. These changes in business practice help explain the success of the rational-expectations approach in academic writing.¹³⁷ They also help explain the emergence of the disinterested director in a mediating role in the *Principles*.

During the postwar period, investors have become better able to protect themselves. Today, they tend to hold diversified portfolios of liquid securities traded through professional intermediaries. During the first part of this century, when commentators first focused on the unprotected small investor, they did not. At that time, a handful of investment bankers dominated the capital markets.

135. For an example of judicial responsiveness to the values of business actors, compare the opinions of Judges Clark and Friendly in *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962). The question was whether the sale of a 28.3% block of stock might amount to a breach of fiduciary duty under the sale of control doctrine. *Id.* at 573; see *supra* note 60. Friendly, worried about the fiduciary problems of the sale but lacking support in state law, advocated that the federal court say nothing at all. *Id.* at 581-82. Clark would have remanded for development of a record: "[P]articularly in view of our lack of knowledge of corporate realities and the current standards of business morality, I should prefer to avoid too precise instructions to the district court . . ." *Id.* at 579.

136. Jensen & Meckling, *supra* note 87, at 343-57.

137. For a fuller exposition of this point, see William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1517-26 (1989).

Moreover, few individuals invested through intermediaries.¹³⁸ By the time the contractual conception of the firm appeared in economics in the 1970s, the capital markets, supported by Depression-era legal reforms, had been transformed. They offered a more reliable place for trading. This change has encouraged the technical process of "securitization," through which additional classes of investments have become exchangeable and liquid.¹³⁹ Competitive financial intermediaries holding well-diversified portfolios also have appeared.¹⁴⁰ These institutions practice the economists' self-protective theories and make this practice available to small investors. They have begun to replace unprotected small individuals as the conventional "investor."¹⁴¹ As a result, the old policies of investor protection have lost much of their hold on legal discourse.

These changes have made the discrete contract an appropriate basis for understanding and evaluating corporate security holding relationships. In effect, the fiduciary principle suffered a loss of support in business practice. Self-protective capacity, anonymity, and speedy entrance and exit have made the traditional fiduciary indicia of power and dependence less apparent in the corporate atmosphere. The rational-expectations justification of fiduciary law carries this practical adjustment to the level of theory.

But these changes do not by any means deliver us into the discrete world hypothesized by Jensen and Meckling. The corporation is too complex an institution. It requires a multi-sided description.¹⁴² At one level, sophisticated investors with diversified portfolios enter into discrete short-term participations. At the same time, in any particular corporation, the shareholders as a whole make a permanent capital investment. They lack the benefit of an institutional structure that puts them in a position of bargaining reciprocity and must rely on someone else to manage the capital. Even assuming widespread institutional holding, cognizable shareholder

138. Richard Whitely, *The Transformation of Business Finance into Financial Economics: The Roles of Academic Expansion and Changes in U.S. Capital Markets*, 11 ACCT. ORGANIZATIONS & SOC'Y 171, 181 (1986).

139. See generally JAMES C. VAN HORNE, *FINANCIAL MANAGEMENT AND POLICY* 527-29 (9th ed. 1992).

140. See Robert A. Taggart, Jr., *The Growth of the "Junk" Bond Market and Its Role in Financing Takeovers*, in *MERGERS AND ACQUISITIONS* 5, 7 (Alan J. Auerbach ed., 1988).

141. Contemporary scholarship focuses on ways to harness increasingly concentrated institutional shareholdings to effect governance results. See, e.g., George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 907-15 (recommending proxy solicitation by 10 or 20 largest holders). Direct legal intervention to protect the unsophisticated, small shareholders does not figure into contemporary governance discussions as a policy imperative. Cf. Gordon, *supra* note 88, at 1557 (arguing that no special protection of uninformed investors is necessary in connection with charter terms of companies doing initial public offerings).

142. Traditional corporate doctrine does manage a multi-sided, if still imperfect, picture of the corporation. See *supra* text accompanying notes 78-83.

dependence and management power remain. Moreover, the group of shareholders can diversify risks of mismanagement only to an extent. Ultimately, investors stand on one side in our institutional framework and managers on the other. One side still may injure the other, despite diversification. In short, a basis remains to sustain the old picture of separated ownership and control.¹⁴³ The ratification of the legitimacy of mandatory fiduciary duty by academic writers and the drafters of the *Principles*¹⁴⁴ confirms this point.

The positive picture remains unsettled. Investors and managers continue to make relational adjustments, as shown by some recent developments in business practice. First, the momentum of corporate restructuring fell off drastically when credit tightened.¹⁴⁵ This decline has disempowered market actors relative to managers and caused discrete contracts between market actors to play a lesser role in corporate power allocation.¹⁴⁶ The microeconomic story of market constraints on management discretion has lost force correspondingly.¹⁴⁷

Second, institutional investors, particularly public pension funds,¹⁴⁸ have become assertive in corporate governance matters.¹⁴⁹ This development suggests that institutional holdings have become

143. See *supra* note 84. According to the latest economic studies, the capital asset pricing model's explanatory capacity is smaller than formerly supposed. See Eugene F. Fama & Kenneth R. French, *The Cross-Section of Expected Stock Returns*, 47 J. FIN. 427, 429-40 (1992). Possibilities for shareholder injury increase accordingly.

144. See *supra* text accompanying notes 5-10.

145. The number of LBO restructurings peaked at 125 in 1988; the dollar amount of those restructurings peaked in the last quarter of 1988. The market collapsed in the fourth quarter of 1989. In the first half of 1990, only 11 new LBOs were announced. See Arthur Fleischer, Jr., *Mergers and Acquisitions in the 1990's*, in 2 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION, at 131, 134 (PLI Corporate Practice Course Handbook Series No. 713, 1990).

146. For a contradictory theory of the rise of the market for corporate control and the empowerment of market actors, see Bratton, *supra* note 137, at 1517-26.

147. Even Easterbrook and Fischel, the principal proponents of the market-constraint story of corporate governance, have reconsidered the scope of the operative market. See EASTERBROOK & FISCHEL, *supra* note 66, at 168-70, 218 (noting that the "proliferation of state antitakeover statutes" calls into question whether state competition for corporate charters is beneficial).

148. The California Public Employees Retirement System ("CalPERS") has been the most active. See, e.g., *Pension Fund Petition Could Prompt Broad Changes in SEC's Proxy System*, 5 Corp. Couns. Wkly. (BNA), No. 9, at 8, (Feb. 21, 1990) (reporting CalPERS' petition for changes in the SEC proxy rules to facilitate communication and action among shareholders); Eric N. Berg, *Sears Is Urged to Set Up Advisory Panel of Big Holders*, N.Y. TIMES, Dec. 4, 1990, at D3 (reporting CalPERS' proposal of a nine-member shareholder advisory committee to advise floundering managers). But private funds also have taken a more aggressive posture. See Gilson & Kraakman, *supra* note 99, at 867-68 n.12 (noting that Fidelity Investments has removed investment limitations on its mutual funds to allow them to purchase more than 10% of a company's stock, join in a proxy fight, or seek the sale of a company).

149. Their efforts have taken three directions. First, they have used their votes and voices actively to discourage defenses against the operation of the market for corporate control and to encourage more aggressive use of the shareholder franchise. Second, and more important, they have publicly criticized certain managers and have urged the creation of shareholder advisory committees. Finally, they occasionally have sought to influence the selection of their portfolio companies' outside directors. Gilson & Kraakman, *supra* note 99, at 892-95. For a survey of recent activities, see John Pound, *Beyond Takeovers: Politics Comes to Corporate Control*, 70 HARV. BUS. REV., Mar.-Apr. 1992, at 83.

large enough to limit the force of the old "Wall Street Rule." Given sufficiently large holdings, diversification and portfolio adjustment may not be the final steps in the process of maximizing return on investment. Expenditures of time and money in corporate governance processes may produce greater returns than selling and moving on to the securities of yet another suboptimally managed firm.¹⁵⁰

Suppose that collective action by institutional holders becomes an everyday part of corporate life. The power structures of public corporations would look somewhat different as a result. Under the still meaningful separation of ownership and control, management stands on one side of a power divide and market actors stand on the other. They have little means of power allocation inter se other than the drastic move of a hostile tender offer. Institutions in the habit of talking to each other might end up forming coalitions and go on to sustained interaction with management.¹⁵¹ Power would flow to them as a result. Legal duties might change accordingly. The legal picture of complete shareholder dependence becomes less appropriate, the classic shareholder collective action problem having been surmounted to some extent. Possibilities for opting out would open up.¹⁵² This would not necessarily cause the displacement of traditional fiduciary ideology from the law, however; arm's-length "market" treatment of these relationships would not be appropriate either. Indeed, given the continued existence of a dependent subclass of shareholders, the fidelity of the newly empowered institutions becomes a legal concern. The projected picture less resembles the cold contracting world of the microeconomic model than the colorful world of the close corporation. As with close corporations, special balances of self-interest and responsibility would develop under the fiduciary rubric.

B. Relational Flexibility Without a Contractual Essence

The notion that traditional fiduciary concepts invite wrong answers to corporate questions implies a need to reconceive the doctrine's conceptual underpinnings. This search for additional

150. For a cost-benefit analysis, see Black, *supra* note 99, at 570-585; see also Special Report, *Economic Reasoning Changing Direction of SEC Deliberations*, *Grundfest States*, 22 Sec. Reg. & L. Rep. (BNA) 206, 209 (Feb. 9, 1990).

151. For a discussion of the implications of coalition building in the context of corporate control transfers, see Coffee, *supra* note 46, at 1531-49.

152. On the other hand, it might take considerable structural positive-law reform to bring this picture into reality. Professor Dent proposes a fundamental restructuring that puts the proxy machinery in shareholder hands. He suggests that the law should give a committee of the 10 or 20 largest shareholders exclusive access to the corporate treasury to pay for proxy solicitations. See George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 Wis. L. Rev. 881, 907.

normative flexibility leads to contract law's less intense fairness norm. As with the title of the *Principles*' code, "loyalty" is replaced with "fair dealing." But, going beyond the title, the change is made thoroughgoing.

Unfortunately, this search for a right answer invites a different sort of wrong answer. Responsiveness to business practice will not find its way into the law's fabric if an essential corporate contract is constructed to replace a discarded notion of essential fiduciary duty. All the contractual theories of the corporation articulated in recent years pose this problem.¹⁵³ Furthermore, the problem of wrong answers has been overstated. It lies mostly in the law reviews themselves. Commentators tend to respond to one another at the same time that they respond to the cases. As we have seen, traditional fiduciary principles overlap in part with the assertions of antimanagementist academics.¹⁵⁴ But the two are distinct at bottom because fiduciary doctrine never follows from a single, well-defined theory of corporate governance. Academic corporate-governance discourse tends to lose sight of this point, mistakenly assuming that antimanagementist assertions and doctrinal fiduciary concepts follow from a single point of view. The conflation, not the case law, creates the threat of fiduciary overkill.

The solution to the problem is de novo examination of corporate fiduciary doctrine without an antecedent paradigmatic program of one or another sort. Like contract law, corporate fiduciary law turns out to be sensitive to the facts of particular relationships. But, because the two bodies of law have evolved in the service of different relationships, their structural frameworks are not interchangeable.

1. *A Good-Faith Norm*

Consider, as a means to the end of evaluating corporate doctrine's relational flexibility, Professor Coffee's suggestion that we look to contract law's "good faith" norm in articulating the scope of fiduciary duties. Coffee's treatment is the most relationally sensitive of the recent discussions of corporate law's contractual aspects. He avoids the constraints of microeconomic notions of contract and looks both to actors in practice and to positive law for relational substance. His approach even has a mediative aspect. He draws on the open-ended "omitted term" concept of contract doctrine and accords gap-filling judges the power to style themselves as police against ex post opportunism.¹⁵⁵ But Coffee also proposes a normative essence: "good faith." He offers this as a minimum standard

153. See *supra* text accompanying notes 126-28.

154. Antimanagementists can be as critical of fiduciary doctrine as can Chicago School economists. For general criticism, see, for example, William L. Cary, *Federalism and Corporate Law: Reflections on Delaware*, 83 YALE L.J. 663, 673-74, 677-683 (1974) (criticizing the Delaware courts' application of the duty of loyalty), and Chirelstein, *supra* note 85, at 205-07 (recommending abolition of common law fiduciary duty and fairness standards respecting managers in favor of legislated rules or standards of a more specific character).

155. Coffee, *supra* note 90, at 1623, 1653-64.

for mandatory corporate law.¹⁵⁶

Coffee's good faith norm is plausible. The "good faith" actor avoids self-interested action that is unnecessary to the realization of his or her own contract expectations and that impairs the expectations of the other party.¹⁵⁷ This good faith concept has a healthy flexibility when inserted into corporate law. It avoids overplaying norms of management selflessness. At the same time, it recognizes the value and necessity of self-abnegation. To some extent, therefore, it respects the traditional dynamic of corporate fiduciary doctrine. Indeed, good faith often is the norm actually applied in many corporate cases decided under the "fiduciary" appellation.¹⁵⁸

Unfortunately, the fit is still far from perfect. Contract law and corporate law, viewed relationally, overlap at significant points without being coextensive. "Good faith," when applied to corporate contexts, entails normative realignment. Values get lost in the process.

Contract law responds to a range of situations, from the simple sale of goods for money to long-term, open-ended situations of supply or co-ownership. Contract cases range between discrete and relational transactions, and between arm's-length and interdependent postures on the actors' parts. The reactions of decision makers dealing with relationships falling along these ranges tend to be colored by their respective individualistic or altruistic dispositions.¹⁵⁹ As a result, norms of selflessness have a volatile pattern of application. In practice, the "good faith" mandate is not taken as a directive to recognize limitations on self-interested value maximization. It merely invites consideration of the possibility. In many situations, the presumption remains against the party requesting that self-interest be constrained,¹⁶⁰ even though the *Restatement (Second) of Contracts* lays down good faith as an absolute value attaching to all

156. *Id.* at 1674 (combining good faith with the contract notion of unconscionability).

157. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 900.

158. *See, e.g.*, *Speed v. Transamerica Corp.*, 235 F.2d 369, 373 (3d Cir. 1956) (discussing a failure to disclose facts in connection with exercise of call right of convertible security); *Smith v. Atlantic Properties, Inc.*, 422 N.W.2d 798 (Mass. App. 1981) (discussing the self-interested use of a close-corporation veto power).

Coffee notes, probably correctly, that rendering fiduciary duties in good faith terms would cause little change in the terms of traditional self-dealing cases. Coffee, *supra* note 90, at 1665.

159. *See generally* Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1713, 1723-24 (1976) (arguing that legal doctrines fashioned by legislators and judges are affected by altruism and individualism).

160. Cases dealing with corporate bond contracts make a good example. Bondholders who have lost value as the result of issuer opportunism repeatedly make "good faith" claims, only to be told by the judge that theirs is an arm's-length contract that permits self-interested value appropriation short of fraud. *See, e.g.*, *Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504, 1516-23 (S.D.N.Y. 1990).

contracts.¹⁶¹

Corporate law responds to a wider range on the relational continuum. Certain corporate situations track contract patterns very closely. For example, with corporate shareholder-to-shareholder duties, we find zones of self-interest and zones in which good faith tempers self-interest. Like contract law, corporate law here mediates conflicts between the accompanying norms.¹⁶² But other corporate situations do not follow contract patterns. These involve heightened interdependence absent from the subject matter of basic contract law. Here, in the zone of the duty of loyalty, corporate law subordinates self-interest in a mode not replicated in contract law.

2. *Comparing the Patterns*

The corporate duty of loyalty imposes a burden of justification respecting self-interested activities. As we have seen, the actors subject to the duty, by employing the appropriate procedures, can shift the burden to the objecting shareholder. Under existing law, however, the shift in the burden does not preclude a shareholder showing of substantive unfairness.¹⁶³ This fairness determination does, of course, require mediation between self-interest and self-sacrifice. Viewed in this way, the corporate duty looks like the contract good-faith duty, which calls for the same mediation.

The similarities, however, are not thoroughgoing. The corporate-law mediation proceeds on a mandatory foundation; the director or officer cannot avoid the possibility of substantive scrutiny. The contract good-faith mediation proceeds in a different context. Contract enforces transactions in the first instance on a formal showing of consent and consideration. Self-interest is assumed and accepted without scrutiny; the doctrine specifies that legal decision makers should not inquire into the equivalency of the values exchanged.¹⁶⁴ Of course, this equivalency inquiry nevertheless can arise under modifying doctrines such as good faith and unconscionability, but only on a special showing that takes the case out of the normal regime of sanctioned self-interest.¹⁶⁵ Thus, contract law, and the core of corporate fiduciary law, employ distinct presumptions respecting the appropriateness of self-interested behavior. The good faith norm, despite similar verbiage, is contextually bound. It asks materially less of corporate actors than does the fiduciary fairness norm.

Corporate shareholder-to-shareholder duties, in contrast, support direct comparison with contract law. Corporate doctrine remits shareholders to a contractual world. Absent fraud, it approves self-

161. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

162. See *infra* notes 166-75 and accompanying text.

163. See *supra* note 31 and accompanying text.

164. See RESTATEMENT (SECOND) OF CONTRACTS § 79; *id.* § 79 cmt. c (1979). Viewed from an economic perspective, this provision of contract doctrine has the same roots as the contractarian challenge to judicial scrutiny of corporate transactions for fairness. The assumption is that the parties are better equipped to determine price than the judge. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 71 (2d ed. 1977).

165. See E. ALLEN FARNSWORTH, *CONTRACTS* §§ 4.1, 4.9 (2d ed. 1990).

interest with respect to votes and sales of shares.¹⁶⁶ Here, traditionally, the law gave us the opposite of fiduciary overkill—the close corporation freezeout in which bad faith majority shareholders capture the returns on minority shareholders' investments.¹⁶⁷ Of course, shareholder-to-shareholder law never quite replicated the traditional normative climate of sales of fungible goods; unlike widgets, shareholder votes cannot be sold. Mandated cooperation asserts itself to make vote selling a breach of duty.¹⁶⁸

As we have seen, corporate law has developed doctrines that restrain self-interested conduct at the shareholder level.¹⁶⁹ Twentieth-century contract law has developed the doctrines of good faith and unconscionability to perform analogous tasks. Many parallels can be drawn between the two restraining doctrines.

The corporate case law has a mediative aspect.¹⁷⁰ The cases effect situational accommodations of self-interest and cooperation. In so

166. HARRY G. HENN & JOHN R. ALEXANDER, *LAWS OF CORPORATIONS* 654-56, 723-24 (3d ed. 1983).

167. For a description of this phenomenon, see CLARK, *supra* note 82, §§ 12.1, 12.4. For a recent summary of the evolution of legal norms respecting private ordering in close corporation contexts, see Thompson, *supra* note 91, at 392-403.

168. See *Chew v. Inverness Management Corp.*, 352 A.2d 426, 430 (Del. Ch. 1976); *Macht v. Merchants Mortgage & Credit Co.*, 194 A. 19, 22 (Del. Ch. 1937).

169. See *supra* text accompanying notes 44-46.

170. Both the case law and the mediative aspect have long historical roots. The leading late nineteenth-century case is *Meeker v. Winthrop Iron Co.*, 17 F. 48 (1883). There, a corporation that failed to secure a favorable mining lease purchased a majority of the stock of the potential lessor, took control, and effected adoption of the previously unsuccessful lease proposal. The minority stockholders brought a successful action. The court took the majority control situation as an occasion for inquiring into the adequacy of the consideration on the lease. *Id.* at 49-51. Said the court:

The ownership of a majority of the capital stock of a corporation invests the holders thereof with many valuable incidental rights. . . . But, in thus assuming control, they also take upon themselves the correlative duty of diligence and good faith. They cannot lawfully manipulate the company's business in their own interests to the injury of other corporators.

Id. at 50. Citing this case and a standard of "utmost good faith" based on majority control power, Victor Morawetz set out a majority-to-minority fairness duty in his 1886 treatise. See VICTOR MORAWETZ, *A TREATISE ON THE LAW OF PRIVATE CORPORATIONS* § 477, at 451-452 (Boston, Little, Brown, & Company, 2d ed. 1886). Significantly, Morawetz and his contemporaries set out an additional contractual basis of responsibility. The majority could not depart from the terms of the charter, see *id.*, and had to maintain the corporation's original objects of formation.

The majority-to-minority duty thus entered the doctrine in an awkward posture. Stockholders did not owe fiduciary duties to each other, SEYMOUR D. THOMPSON, *COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS* § 8601, at 7207 (San Francisco, Bancroft-Whitney Company 1894), but majority stockholders could in some cases owe duties that resembled fiduciary duties to minorities. *Id.* The phrase "quasi trust relation" appears. CHARLES F. BEACH, JR., *COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS* § 70, at 140-41 (Chicago, T.H. Flood & Co. 1891); see also WILLIAM W. COOK, *A TREATISE ON THE LAW OF STOCK AND STOCKHOLDERS* § 662, at 697-698 (New York, Baher, Voorhis & Co. 1887). For later restatements of the doctrine, see HARRY W. BALLANTINE, *BALLANTINE ON CORPORATIONS* § 278 (rev. ed. 1946); WILLIAM L. CLARK & WILLIAM L. MARSHALL, *A TREATISE ON THE LAW OF PRIVATE CORPORATIONS* §§ 626-627, at

doing they take on an experimental quality. Consider three leading Massachusetts cases that constrain the classic freezeout under the fiduciary rubric.¹⁷¹ The first opinion lurches in the direction of a strict rule of equality.¹⁷² The second pares back the rule to a standard balancing of equality and business purpose.¹⁷³ This purportedly "fiduciary" rule, applied to an intracorporate deadlock situation in the third case, becomes a reasonableness review of the tactical excesses of arm's-length players.¹⁷⁴ At this point, the court's analysis of fiduciary duty becomes indistinguishable from "good faith" scrutiny of performance patterns under long-term contracts.¹⁷⁵

The same tentativeness and adaptability appear in cases employing the majority-to-minority shareholders' duty to protect holders of publicly traded securities. Courts have imposed strong fiduciary bars, only to retrench in later cases involving exercises of call rights,¹⁷⁶ sales of control blocks at premium prices,¹⁷⁷ and takeout mergers.¹⁷⁸ In these cases, as in the Massachusetts close-corporation cases, the courts initially recognize that the free play of self-interest under the traditional doctrine presents an ethical problem. They respond with familiar fiduciary constraints.¹⁷⁹ Over time, it turns out that norms of welfare and reciprocity counsel a more even-handed mediation. As the doctrine evolves, it approximates the contractual good-faith restraint.¹⁸⁰

1904-05 (1901); CHARLES B. ELLIOTT, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS §§ 432, 433, 474 (Stewart Chaplin ed., 5th rev. ed. 1923); JOHN T. MULLIGAN, LAW OF CORPORATIONS § 74, at 235-237 (1913).

Today, of course, we call the majority-to-minority duty "fiduciary." Even so, the "quasi-fiduciary" appellation of a century ago would not be inappropriate.

171. In chronological order, these are *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505 (Mass. 1975), *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1977), and *Smith v. Atlantic Properties, Inc.*, 422 N.E.2d 798 (Mass. App. Ct. 1981). For a very different reading of these cases, see Mitchell, *supra* note 86, at 1699-1714 (criticizing the succession of progressive departure from the fiduciary principle).

172. *Donahue*, 328 N.E.2d at 515-17.

173. *Wilkes*, 353 N.E.2d at 663.

174. *Smith*, 422 N.E.2d at 801-03.

175. See, e.g., *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 614 (2d Cir. 1979); *Parev Products Co. v. I. Rokeach & Sons*, 124 F.2d 147, 149 (2d Cir. 1941).

176. Compare *Zahn v. Transamerica Corp.*, 162 F.2d 36 (1947) with *Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir. 1956) (damages phase of same case).

177. Compare *Perlman v. Feldman*, 219 F.2d 173, 175-76 (2d Cir.) (holding a majority stockholder to a standard of strict fiduciary duty during a controlling interest sale), *cert. denied*, 349 U.S. 952 (1955) and *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464, 471 (Cal. 1969) (same) with *Zetlin v. Hanson Holdings, Inc.*, 397 N.E.2d 387, 388 (N.Y. 1979) (applying the less strict good faith fiduciary duty to a sale of stock by a majority shareholder).

178. Compare *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977) (holding that majority shareholders owe the minority a fiduciary duty) with *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983) (holding that the minority shareholder must demonstrate unfairness to win a suit challenging a cash-out merger).

179. See *supra* notes 171-75 and accompanying text.

180. Ironically, in the cases involving publicly traded securities, the modified fiduciary duty doctrine provided firm ground for the restructurings of the late 1980s. Decisionmakers in effect refrained from imposing cooperative norms so that a great experiment in wealth maximization through arm's-length contract could go forward without a significant burden of litigation from those injured in the process.

The free play of self-interest at the shareholder level can be constrained by contract as well as by judicial decree. With mutual promises regarding voting and management, close-corporation shareholders contain the dangers of self-interested conduct by imposing rules of cooperation on themselves. Here the mediation of self-interest and cooperation follows a crooked path to a stable balance. Shareholders "opt out" of the juridical corporate structure in order to "opt in" to a self-imposed system of mutual responsibility. Shareholders resort to contract to achieve mutual responsibility because they mistrust one another. Contractual devices are required in the close-corporation context because the law, even with shareholder-level fiduciary protections well-established, offers insufficient *ex ante* protection of the shareholders' trust. But, just as traditional corporate shareholder-to-shareholder law had to be modified to allow for fiduciary protections, it also had to be modified to allow for contract devices. Shareholders' agreements tend to traverse the structural norm of management by the board of directors. This norm, which pursues an ideal of group action and responsibility, had to be modified so that the same goal could be achieved through arm's-length negotiation.¹⁸¹ But the conflict arose less between "corporate" and "contractual" principles than between clumsy and adroit integrations of self-interest and cooperation. Here, contract succeeds better.

Reconsider Professor Coffee's good faith proposition in the light of this survey. It assumes that corporate law should have a single positive and normative center of gravity. This assumption is widely shared. We can read the history of corporate legal theory during the past decade or so as a tripartite struggle among backers of three competing centers of gravity. Antimanagerialists advocated a strong fiduciary norm, economic writers promoted self-interest, and institutional contractarians—such as Coffee—backed good faith.¹⁸² This discourse meets a positive objection: relationships in and around a single corporation do not have a single normative center of gravity; they entail many norms. The actors mediate internally between these norms, and the law serves as a backstop by providing additional mediation and a few mandates. The actors and lawmakers both draw on good faith and traditional fiduciary standards of fairness, and at the same time sanction the self-interested infliction of injury on others.

181. See Coffee, *supra* note 90, at 1642-45.

182. Most in the latter group treat good faith as a rational maximizing tool. See Bratton, *supra* note 77, at 70-71 (noting that scholarship critical of the neoclassical "nexus of contracts" theory of the firm tends to proceed in a rational expectations framework and conclude with a finding of contract failure). Coffee's discussion is notable for the influence of the conventional conception. Coffee, *supra* note 90.

In particular situations, normative reasons may be suggested for reshaping the law to allocate more weight to one or another of the norms. But a global presumption in favor of one norm or another seems unjustified. Here the inherited body of corporate legal doctrine shows greater refinement than contemporary corporate legal theory. The doctrine holds to the fiduciary norm at the board level, but not absolutely. At the shareholder level, it admits good faith with much the same situational skepticism that we find in contract doctrine. Self-interest, tempered by the insider trading rules, prevails on the securities markets.¹⁸³

Corporate law, then, applies the same values in corporate contexts that contract law applies in contract contexts. No basis results for realignment of corporate doctrine to a template drawn from basic contract law, even under the values that inform contract law. The two deal with different relationships.

C. Summary

This Part's relational defense of the inherited body of corporate fiduciary law has significant points in common with the *Principles'* code, at least as explicated in the previous Part's discussion of its drafters' implicit choices. Both aspire to leave the law's foundations open and admit the possibility that developments in business practice will change legal norms. Both also avoid the narrowing effects of politically driven paradigms. Oddly, though, recognition of these points of consonance between the two implies a point of dissonance. If fiduciary law is as flexible and sensitive to the values of actors in practice as this Part suggests, then it is not clear why the code needed to take steps to strengthen its self-regulatory aspect. The code's recognition of the judgments of disinterested directors does add an explicit guaranty of a full hearing for corporate purposes and business exigencies. But it does so at the cost of a risk of impairment of the integrity of vital norms. The cost-benefit determination remains open.

Conclusion

It is difficult to fault the *Principles* for recognizing that a complex set of values must be synchronized in the regulation of self-dealing transactions and recommending that corporate fiduciary law should privilege mediation over prohibition by rule. Nor can the code be faulted for recognizing that business people have a role in the creation of fiduciary law and for encouraging their participation in the lawmaking process. The problem arises when the code articulates the business actors' participatory role. By conceding a measure of adjudicatory authority to business people while holding out the possibility of later judicial reversal under an open standard, the code

183. Adjustments of norms in the doctrine have been accomplished with finesse. Effective legal mediation lies as much in the recognition and correction of a misstep as in getting it absolutely right the first time.

brings business actors into the lawmaking process but leaves the precise definition of their role for later solution. That solution's contours will depend on the relative credibility of board room determinations as adjudications and on the vitality of the code's limiting fairness norm.

The time for according weight to the board room determination has not arrived and could be long in coming. Despite the presence of the *Principles'* independent directors, board room processes still do not assure that fiduciary determinations will include adequate consideration of the investor's point of view. This lack of process integrity is material, because the fiduciary norm remains vital. It is one thing to say that the norm's legitimate articulation requires the input of business people. It is quite another to say that a board called upon to approve a colleague's self-interested transaction should be the primary source for such input. We can rely on other channels. Fiduciary law stays sensitive to the values of business people as the structural proposition. Our corporate law system provides endless opportunities for management participation in policy formulation. Given jurisdictional competition and the leadership role of the management-responsive state of Delaware, business preferences are assured of serious consideration.

The *Principles'* provision for self-regulation of conflict of interest transactions therefore should be seen as a structure for limited, present implementation but possible future expansion. For now, the business actors whom the code brings into the legal process should be reviewed strictly. Their tasks are to develop a record of fact and to apply law formulated elsewhere. Courts should not hesitate to overrule their normative judgments.