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# A More Realistic Approach to Directors' Duties

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# A MORE REALISTIC APPROACH TO DIRECTORS' DUTIES

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Expectations for what fiduciary duties can achieve in the corporate context are unrealistic.[1] This segment of the law—and the alleged deficiencies therein—is blamed for corporate scandals, securities fraud, failed business plans, and even a company's insolvency.[2] Risk is, however, inherent in business, and human beings are flawed. Fiduciary duty law cannot change these basic facts. To the extent that we think it can, we will continue to be disappointed and frustrated.

This is not to suggest that we let managers and businesses run amuck. Rather, I suggest we acknowledge the limitations of fiduciary duties and reexamine our objectives in imposing them upon those entrusted with our business ventures. In thinking about what fiduciary duty law should really achieve, I maintain that it should encourage good actors to do their *very* best and should punish bad actors. It should not ensnare those directors who are honest and diligent, but unlucky.

Does existing fiduciary duty law accomplish these objectives? To some extent it does, but the process can be turbulent, expensive, and litigious.[3] We can

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1 For a thorough overview of general fiduciary duty law, *see* TAMAR FRANKEL, FIDUCIARY LAW 7-13 (2011).

2 *See, e.g.,* JONATHAN MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN (2008) (advocating that less government regulation is needed to ensure that managers of public companies keep their promises to investors); Jill E. Fisch, *The Overstated Promise of Corporate Governance*, 77 U. CHI. L. REV. 923, 927 (2010) (reviewing JONATHAN MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN (2008)).

3 Consider the Disney case that spanned over eight years, exposed questionable board practices, provided guidance on "best practices" in this context, but ultimately imposed no meaningful accountability. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005) *aff'd*, 906 A.2d 27 (Del. 2006). *See also* Ann M. Scarlett, *Confusion and Unpredictability in Shareholder Derivative Litigation: The Delaware Courts' Response to Recent Corporate Scandals*, 60 FLA. L. REV. 589, 603–04 (2008) (discussing the shift in how courts adjudicate derivative actions).

use duties in a more effective manner. I believe that we can help directors better serve their companies if we clarify and codify expectations for director behavior. Nobody benefits from uncertainty, particularly in times of crises when directors typically face intense pressure from competing interests, and the law provides insufficient and sometimes conflicting direction.

Put yourself in the shoes of a director of a distressed company. The company's management team has just informed you that the company likely will not have sufficient funds to make its next quarterly interest payment on its outstanding bonds, triggering a cross-default of all of the company's debt instruments. Management suggests that it might be able to negotiate a forbearance agreement with the indenture trustee of the bond issuance, but that will not necessarily solve the problem. Although most of the company's cross-default provisions are triggered by an actual default, the company's senior secured loan facility contains language that arguably might trigger a cross-default upon execution of the forbearance agreement. Management proposes "buying time" from both the senior secured lenders and the bondholders through a combination of a cash payment and renegotiated debt covenants that provide the debtholders more control over the company, at least until the debt is repaid. Management proposes to move forward with this plan in the next seven to ten days and would like the board's blessing. What should you, as a director, do?[4]

You turn to counsel, who informs you that your fiduciary duties remain largely unchanged, regardless of the company's financial condition. You must satisfy your duties of care and loyalty; consequently, you should be well informed and free from conflict and pursue a course of action that is in the best interests of the company.[5] If the company is still solvent, even if marginally so, your

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[4] For an insightful discussion of the challenges facing directors in these scenarios, *see* Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., Civ. A. No. 12150, 1991 WL 277613, at *1156 n. 55 (Del. Ch. Dec. 30, 1991).

[5] *See*, *e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 2-405.1(a) (West 2013) (requiring directors to perform duties in good faith, in a manner reasonably believed to be in the corporation's best interests, and with the care of an ordinarily prudent person in a like position under similar circumstances); Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith. . . . Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."). In *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963), the Delaware Supreme Court noted that:

> [I]t appears that directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men

decisions also should be in the best interests of the shareholders.[6] If the company is now insolvent, you can consider the interests of creditors in determining what is in the company's best interests.[7] Moreover, the lawyer—like most practitioners in this space—short-hands these duties as working to "maximize entity value" and notes that acting accordingly will not prevent you from being sued but will protect you from liability.[8]

What does a director do, practically speaking, with this lawyer's advice? My personal response would be something like, "Well, thanks for nothing." This lawyer-speak does nothing concrete to help the director make better decisions or decisions that work to the company's benefit. As the director's lawyer indicated, acting in accordance with these duties does not protect the director from litigation, which includes: being named a defendant not only in the complaint but also possibly in sources like *The Wall Street Journal*; being significantly distracted from regular duties; and, probably, suffering much more stress and anxiety, among other things.

Although neither the law nor lawyers should venture into giving business advice, the law can reward good business practices that achieve desired legal objectives. It also can punish wrongdoing—lying, stealing, and cheating. Yet, we

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> would use in similar circumstances. Their duties are those of control, and whether or not by neglect they have made themselves liable for failure to exercise proper control depends on the circumstances and facts of the particular case.

*See also* Gay v. Maryland Deposit Ins. Fund Corp., 521 A.2d 1205, 1213 (Md. 1987) (stating the duty of loyalty under Maryland law).

6 N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007) ("It is well established that the directors owe their fiduciary obligations to the corporation and its shareholders.").

7 *See*, *e.g.*, *In re* Bear Stearns Litig., 870 N.Y.S.2d 709, 737 (N.Y. Sup. Ct. 2008) ("The directors still have the 'duty to maximize the value of the insolvent corporation for the benefit of those having an interest in it' and are required to 'engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation.'") (citing *Gheewalla*, 930 A.2d at 103); Finch v. Southside Lincoln-Mercury, Inc., 685 N.W.2d 154, 166-67 (Wis. Ct. App. 2004) ("[T]here can be little dispute that Wisconsin courts recognize a fiduciary duty owed by the officers and directors of a corporation to maximize the value of the corporation's remaining assets for the benefit of its unsecured creditors once the corporation is both (1) insolvent and (2) no longer 'a going concern.'").

8 Notably, Delaware case law suggests that working to maximize "enterprise value" as opposed to the value of the common stock may not comply with directors' duties, at least in the context of solvent or nearly solvent companies. *See supra* note 7; *see also In re* Trados Inc. S'holder Litig., 73 A.3d 17, 42 n.16 (Del. Ch. 2013) (discussing the difficulty of applying the enterprise value theory).

have not adopted a legal framework that clearly sets these parameters. This essay considers recasting, and to a greater extent codifying, directors' duties in a positive frame to help foster better director oversight. Specifically, this essay: reviews the literature concerning the proper roles of directors and officers in corporate governance; considers existing approaches to developing corporate governance law and regulating director conduct; explains the move towards increased codification of directors' duties under the Companies Act of 2006 in the United Kingdom; and proposes a similar but slightly modified statutory approach, solely with respect to directors' (as opposed to officers') duties in the United States. This essay does not suggest that codifying greater clarity into directors' duties would result in more or less director liability; rather, the primary objective would be to improve director performance outside of the litigation sphere.

**DIRECTOR VS. OFFICER DUTIES**

In the United States, directors are generally said to manage the affairs of the corporation for the benefit of its owners, the shareholders.[9] Many commentators have analyzed this separation of management and ownership structure and the related agency costs that it creates.[10] The literature in this area is rich and useful in theorizing about entity forms and optimal governance structures. Nevertheless, the model on which it is based oversimplifies

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[9] *See*, *e.g.*, ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 121-25 (rev. ed. 1991) (discussing the historical origins of the corporation); William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 756 (2001) ("Shareholder value now sits atop management agendas."); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 357 (1976) ("Millions of individuals entrusts billions of dollars . . . of personal wealth to the care of managers on the basis of a complex set of contracting relationships which delineate the rights of the parties involved."); *see also* DEL. CODE ANN. tit. 8, § 141(a) (2013) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."); MODEL BUS. CORP. ACT § 8.01(b) (2011) ("All corporate powers shall be exercised by or under the authority of the board of directors . . . , and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight of, its board of directors . . . ."). For commentary questioning whether shareholders are the appropriate beneficiaries or the true owners of corporations, *see, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 36-46 (2012) (advocating that shareholders are not owners of the corporation but have a contractual relationship like a bondholder).

[10] *See*, *e.g.*, Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J. L. ECON. 327, 328 (1983); *see also* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1406-07 (1985); Andrei Schleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

companies' governance and capital structures and overlooks the reality of management responsibility at most U.S. companies.

The predominant management form situates the board in an oversight function and the senior officers in the position of control. Directors routinely delegate most, if not all, responsibility for the day-to-day business affairs to the company's officers.[11] Several commentators have addressed this delegation of duty and the shift in power that often accompanies it.[12] Consequently, in many corporations, senior officers make most critical operational and financial decisions in the first instance.[13] Directors only review those decisions if they rise to a level of significance requiring board approval under state law or prove to be ill advised and expose the company to increased risk.[14]

Given the current composition of boards of directors, with at least a majority of most boards consisting of outside directors, boards serving primarily in an oversight function make sense.[15] Directors do not have the time and are not compensated to micro-manage the company's business.[16] They typically bring a

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[11] *See, e.g.*, Olson Bros., Inc. v. Englehart, 211 A.2d 610, 615 (Del. Ch. 1965) *aff'd*, 245 A.2d 166 (Del. 1968), ("Section 141 of Title 8 provides that the business of every corporation 'shall be managed by a board of directors.' . . . [T]he corporation requires management, that is, a board of directors and such officers as may be necessary to accomplish its purpose or purposes."); *see also* MODEL BUS. CORP. ACT § 8.01 official cmt. (2011):

> The phrase 'by or under the direction of [and subject to the oversight of]' encompasses the varying functions of boards of directors of different corporations. . . . [I]n many other corporations, the business and affairs are managed 'under the direction, and subject to the oversight, of' the board of directors, since operational management is delegated to executive officers and other professional managers.

[12] *See*, *e.g.*, Amitai Aviram, *Officers' Fiduciary Duties and the Nature of Corporate Organs*, 2013 U. ILL. L. REV. 763, 766-67 (discussing role of officers in the corporation and citing related literature).

[13] *See*, *e.g.*, Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems,* 48 J. FIN. 831, 864 (1993) ("[T]he CEO almost always determines the agenda and the information given to the board."); Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597, 1608 (2005) ("Too often, delegation of management—necessary and proper—foreshadows the unnecessary and improper relinquishment of the principal's power and duty to control.").

[14] *See* Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127 (2010) (discussing roles, contributions and limitations on inside and outside directors); Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards,* 34 SEATTLE U. L. REV. 1435, 1453-56 (2011) (discussing the role of, and limitations on, boards, particularly outside directors).

[15] *See* Sharpe, *supra* note 14, at 1453-56.

[16] *Id.* at 1453.

variety of skill sets to the table and are adept at both seeing and understanding nuances in the big picture.[17] The company and, in turn, its owners trust directors to put the right people in positions of day-to-day control (the officers and senior managers) and to make sure those people do a good job.

Does that trust make directors fiduciaries? Yes, in a fundamental sense, directors are fiduciaries. That does not, however, mean that directors also are agents of the company in a traditional sense, and corporate law generally does not treat directors as common law agents.[18] This essay builds on the traditional treatment of directors, but leaves open the appropriate characterization and treatment of senior officers of the company.[19] The question then becomes how can we best police director conduct—best practices, common law, or statutory law? The next sections consider this question and summarize the move towards increased codification of company law in the United Kingdom to inform the analysis.

**DEVELOPMENT OF U.S. CORPORATE LAW**

For the most part, directors' fiduciary duties are set by statute, common law, or some combination of the two. For example, they are largely common law based in Delaware,[20] but other states, such as Maryland and Kentucky,[21] follow an

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[17] *Id.* at 1455.

[18] Directors and officers have both traditionally been treated as fiduciaries, with their primary duties stemming from trust law. *See*, *e.g.*, FRANKEL, *supra* note 1, at 96-97. Nevertheless, as Justice Brennan famously noted, "to say that a man is a fiduciary only begins [the] analysis," and corporate law has and continues to evolve with respect to corporate fiduciary duties. SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

[19] Adopting a more definitive distinction between the roles and functions of directors and officers may help promote a more effective governance system. *See infra* notes 44-45 and accompanying text.

[20] *See, e.g.*, Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 888-91 (2012) (explaining different approaches to fiduciary duties in context of incorporated versus unincorporated contexts); Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 705 (2011) ("The [Delaware] General Assembly has never addressed the fiduciary duties of corporate officers, leaving that subject entirely to the judiciary, which has likewise largely neglected these duties. The General Assembly, however, has addressed the fiduciary duties of corporate directors, but not to permit curtailing or negating those duties."); E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1405 (2005) (stating that, although statutory standards, judicial interpretations have largely impacted Delaware fiduciary duty law).

[21] *See*, *e.g.*, KY. REV. STAT. ANN. § 271B.8-300 (West 2013) (requiring directors to perform duties in good faith, in a manner reasonably believed to be in the corporation's best interest and with the care of an ordinary prudent person in a like position under similar circumstances); MD. CODE

approach similar to the Model Business Corporation Act and, to a greater extent, codify directors' duties.[22] Notably, even where codified, much is left unsaid. Cases and statutes consistently refer to directors acting in good faith, on an informed basis, and in the best interests of the company.[23] Exactly what a director should or should not do when challenged by a particular fact pattern is largely developed on a case-by-case basis. In the case of a breach of the duty of care, one gets the sense that it is almost a "you know it when you see it" situation.[24]

Admittedly, this flexibility has benefits: it allows courts to stretch the common law or loosely worded statute to new situations, and consequently, it keeps directors on their toes. An overly rigid statement of directors' duties could allow undesirable conduct to slip through the cracks and limit the ability of litigants and courts to protect the corporation's interests. Policymakers likely cannot devise a rule of law that enumerates all relevant duties and potential infractions because business practices, technology, and financial products evolve too quickly for this approach.[25] Governance law must remain nimble to an appropriate extent.

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ANN., CORPS. & ASS'NS § 2-405.1(a) (West 2013) (applying the same standard as the Kentucky statute); Thomas E. Rutledge, *Is the Statutory Fiduciary Duty of Corporate Directors Exclusive?*, 1, 5-8 (June 26, 2012), *available at* http://ssrn.com/abstract=2064923 (explaining the move towards statutory definition of duties under Kentucky law and the courts' interpretation of those provisions).

[22] *See*, *e.g.*, MODEL BUS. CORP. ACT §§ 8.30, 8.31 (2011) (standards of conduct and liability for directors); John F. Olson & Aaron K. Briggs, *The Model Business Corporation Act and Corporate Governance: An Enabling Statute Moves Toward Normative Standards*, 74 LAW & CONTEMP. PROBS. 31, 35-37 (2011) (describing recent amendments to the MBCA that expand the descriptions of directorial duties).

[23] *See generally* Clark W. Furlow, *Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware*, 2009 UTAH L. REV. 1061, 1067 (2009) (arguing "that any effort to define good faith as an independent fiduciary duty is doomed to failure because the term describes a state of mind . . . whereas fiduciary duties define the way directors are to conduct themselves in office.").

[24] The personal liability of individual directors for most duty of care violations is mitigated by exculpation statutes and indemnification. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2013) ("[T]he certificate of incorporation may also contain . . . [a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director . . . ."); *id.* at § 145(a) ("A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding . . . ."); *id.* at § 145(g) ("A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . .").

[25] For general discussions of the rules versus standards debate in U.S. corporate and securities

But what is appropriate in this context? Flexibility should not come at the cost of certainty; rather, these two objectives should be carefully balanced in structuring directors' duties.[26] Courts generally recognize this delicate balance when evaluating breach of duty cases and often try to provide guidance to directors and practitioners in their judicial decisions.[27] Yet, this guidance can fluctuate, and smaller companies may not have the benefit of counsel to explain and update their directors on these developments.[28] Adopting a framework for directors' duties that, for example, provides more clarity on what it means to "act in the best interests of the company" might help directors *ex ante* in making their decisions but still enable courts to enforce the duty *ex post* when directors' conduct falls short.

The United Kingdom has moved towards greater specificity in the statutory duties imposed on directors under the Companies Act of 2006 (the "Companies Act").[29] Those provisions are discussed below. This essay then considers whether a similar statutory scheme might work in the United States.

**DUTIES UNDER THE U.K. COMPANIES ACT OF 2006**

Directors' fiduciary duties in the United States are based, at least in part,

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laws, *see* Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of "Principles- Based Systems" in Corporate Law, Securities Regulation, and Accounting*, 60 VAND. L. REV. 1411 (2007) (discussing misconceptions about whether complex regulatory systems can be described fairly as either "rules-based" or "principles-based"); Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1152-53 (2003) (discussing the interplay between the common law and SEC rules that define materiality in the context of insider trading). Notably, this debate is not limited to corporate and securities law. For a description of the classic debate between Justices Oliver Wendell Holmes and Benjamin Cardozo in the tort context, *see* Pierre J. Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 379-80 (1985).

[26] Certainty versus flexibility is a central tenet in the rules versus standards dispute. *See*, *e.g.*, Schlag, *supra* note 25, at 399 ("[T]he choice between formulating or interpreting a legal directive as a rule or as a standard is a choice between competing values such as certainty or flexibility, uniformity or individualization.").

[27] *See supra* notes 3-8 and accompanying text.

[28] *See infra* notes 42-43 and accompanying text.

[29] Directors' duties under Chapter 2, Part 10 of the Companies Act of 2006 are part of a larger regulatory scheme governing their conduct, which includes the Insolvency Act 1986, the Insolvency Act 2000, and the new Bribery Act 2010. *See generally* Raymond L. Sweigart & Samuel J. Pearse, *Company Directors' General Duties Under the English Companies Act of 2006*, LEXOLOGY (Jan. 30, 2012), http://www.lexology.com/library/detail.aspx?g=9813cd03-5098-4773-8fed-acec913a08e3 (explaining directors duties under the Companies Act of 2006 in relation to other statutory requirements and case law).

on the equitable doctrine of fiduciary duties underlying trust law in the United Kingdom.[30] Accordingly, the move to codify directors' duties in the United Kingdom can inform the similar debate in the United States.[31] Consider the following explanation of this development:

> In the UK, the question whether the duties of directors should be codified has exercised commentators for over 100 years. So why did the UK opt for a comprehensive codified statement at this stage? The answer is that the climate of opinion had changed. Codification of directors' duties had previously been seen as the search for the Holy Grail, on the grounds that it would be virtually impossible to express in the words of a statute all the intricacies and nuances of the general law. Today, however, the imperative is to improve corporate governance, and the codification of directors' duties is seen as having a role to play in this process. If it reflects best practice, it will guide all directors towards higher standards. Codification should also make the law more accessible to directors and their advisers. Empirical research done for the Law Commissions showed widespread support among serving directors for a statutory statement of directors' duties. This was particularly the case among smaller companies where the directors often did not have access to legal advice. Thus, the current approach towards codification of directors' duties is that it is not just a question of lawyers' law but can play an essential part in making positive improvements in corporate governance.[32]

In several respects, the codification of directors' duties in the United Kingdom strives to serve two distinct purposes: (1) fostering best practices and improved corporate governance *ex ante* and (2) punishing director conduct that harms the corporation and its stakeholders *ex post*. Although a thorough analysis of the U.K. statute is beyond the scope of this essay, certain key aspects of the

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[30] For a discussion of the history of U.S. corporate fiduciary duties, *see* FRANKEL, *supra* note 1; Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997).

[31] *See infra* notes 56-58 and accompanying text.

[32] Mary Arden, *Companies Act 2006 (UK): A New Approach to Directors' Duties*, 81 AUSTL. L. J. 162, 163-64 (2007).

legislation are informative.[33] For example, the Companies Act recognizes seven distinct duties owed by directors to the *company*:[34] the duty to act within powers; the duty to promote the success of the company; the duty to exercise independent judgment; the duty to exercise reasonable care, skill, and diligence; the duty to avoid conflicts of interest; the duty not to accept benefits from third parties; and the duty to declare an interest in a proposed transaction or arrangement.[35] The Companies Act further provides guidance on each duty and establishes the parties entitled to enforce such duties on behalf of the company.[36]

The statutory guidance is notable given the dearth of statutory statements of duties prior to the 2006 legislation and the flexible yet durable structure of the new guidance.[37] A good example of the latter is the statutory explanation of the "duty to promote the success of the company," which is viewed as a duty of loyalty derivation:[38]

> 172. Duty to promote the success of the company
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing

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[33] For a general discussion of directors' duties under U.K. law, *see* Adolfo Paolini & Deepak Nambisan, *Liability of Directors & Officers, in* PROFESSIONAL NEGLIGENCE AND LIABILITY c. 23 (2008).

[34] The Companies Act of 2006 clarifies the prior common law regarding the beneficiary of directors' duties. The Companies Act provides that those duties are owed to the company and should be exercised for the benefit of the members as a whole. Arden, *supra* note 32, at 166*; accord* MODEL BUS. CORP. ACT § 8.30 official cmt. (2011).

[35] Companies Act, 2006, c. 46, §§ 170-77 (U.K.).

[36] The Companies Act of 2006 codifies a refined procedure for derivative actions under U.K. law. It basically provides that only the company, its liquidator, or members acting on its behalf may pursue claims for breach of the statutory fiduciary duties against directors. Companies Act, 2006, c. 46, §§ 260-64 (U.K.).

[37] As Lady Justice Arden observed, "It should be recognised that the codification of directors' duties presented a considerable challenge to those responsible for the drafting. The statement had on the one hand to be clear and accessible and to make the law more predictable, and yet on the other hand not be such as to lose the advantages of flexibility and inherent capacity to develop which judge-made law has." Arden, *supra* note 32, at 165.

[38] This duty reforms the U.K.'s duty of loyalty, which previously was based on directors acting "in the best interests of the company." The revisions are intended to clarify that directors must make decisions in a manner that promoted "the success of the company for the benefit of its members as a whole." *See* Arden, *supra* note 32, at 167; Paul Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act*, 5 EUR. CO. & FIN. L. REV. 48, 65-66 (2008).

so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.[39]

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.[40]

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.[41]

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[39] The factors enumerated in § 172(1) are intended as a non-exclusive list that focuses directors' decision-making on members' interests. Commentators refer to this focus as an "enlightened shareholder value (ESV)." *See* Arden, *supra* note 32, at 165-67; Davies & Rickford, *supra* note 38, at 65-66. As explained by Davies and Rickford, "The ESV approach can be said to embody the insight that the interests of the shareholders are not likely to be advanced if the management of the company conduct its business so that its employees are unwilling to work effectively, its suppliers and customers would rather not deal with it, it is at odds with the community in which it operates and its ethical and environmental standards are regarded as lamentable." Davies & Rickford, *supra* note 38, at 65. Notably, recognizing potentially conflicting U.S. governance norms, this section is not cited for its policy choices but as an example of greater codification of those choices.

[40] The Companies Act of 2006 allows companies to expand or refine their purposes in their articles.

[41] Directors in the United Kingdom owe certain duties to creditors when their company is insolvent or in the vicinity of insolvency. These duties are, to some extent, codified in the Insolvency Act of 1986. Unlike in the United States, U.K. directors must, among other things and subject to certain exceptions, avoid trading while their company is insolvent or when a trade would cause their company to become insolvent. Under U.S. law, directors generally do not owe

The steps enumerated in § 172(1) mirror, in many respects, best practices and are stated in a manner that retains director discretion in implementation. This approach provides boards—particularly boards of smaller companies with less capacity for outside advisors—with a roadmap to follow in making critical decisions.[42] It does not dictate a particular decision-making strategy or require certain pre-defined outcomes.[43] Rather, it is a checklist that could help boards more deliberately consider the issues before them, especially when boards are facing time-sensitive decisions or outside pressures for action.

The management and organizational literature has long touted the value of good processes and decision-making strategies.[44] The discipline of dissecting issues, considering potential alternatives and reviewing contrary evidence better

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fiduciary duties to creditors unless and until the company is insolvent. Although consideration of directors' duties in and near insolvency is beyond the scope of this essay, the decision manifesto, discussed herein, encourages consideration of the company's legal and contractual obligations. Such considerations would involve some appropriate deliberation by the board on the company's obligations to creditors and the impact of any action or inaction regarding the issue on those obligations and also on the company's long-term success.

[42] One primary objective of the Companies Act of 2006 was to make directors' duties more clearly discernible to lay persons serving or desiring to serve as company directors.

> The codification of directors' duties has been heralded as encouraging enterprise as well as simplifying and clarifying the duties owed by directors to their companies. It will not be a matter of great contention that an intended feature of codification was to make it easier for those desirous of taking up directorial roles to better understand the regulatory framework within which to operate.

Tahir Ashraf, *Directors' Duties with a Particular Focus on the Companies Act 2006*, 54 INT'L. J.L. & MGMT. 125, 126 (2012) (citation omitted). The legislature also issued guidance on the duties codified in the Companies Act to further this objective. *Id.* at 135.

[43] Arden, *supra* note 32, at 167 ("The weight to be given to particular matters will remain a matter for the judgment of the directors.").

[44] *See, e.g.*, MICHAEL J. MAUBOUSSIN, THINK TWICE: HARNESSING THE POWER OF COUNTERINTUITION (2009); Marlene E. Turner & Anthony R. Pratkanis, *Mitigating Groupthink by Stimulating Constructive Conflict*, *in* USING CONFLICT IN ORGANIZATIONS ch. 4, 53, 66-67 (Carsten K. W. De Dreu et al. eds. 1997) (discussing value of structuring discussions to mitigate groupthink); Daniel Kahneman et al., *Before You Make that Big Decision . . .*, HARV. BUS. REV., June 2011, at 51, 54 (explaining value of checklists to improve quality of significant decisions); Diane Riordan & Michael Riordan, *Guarding Against Groupthink in the Professional Work Environment: A Checklist*, J. ACAD. & BUS. ETHICS, June 2013, at 6, http://www.aabri.com/manuscripts/131516.pdf ("In addition to directive leadership, two antecedents to the groupthink dynamic are the lack of norms for methodical decision-making and time pressures when making decisions. . . . These threats can be reduced by encouraging a protocol to reach decisions.") (citation omitted).

equips groups, including boards, to make informed decisions.[45] Those decisions may not always be correct, but they likely will be more thorough and leave the company better prepared and aware of the array of possible outcomes.

Admittedly, what constitutes best practices and good organizational behavior may not be appropriate as legislated governance. The next section considers this question in light of U.S. governance norms and the perceived pros and cons to a more regulated approach.

**CLARIFYING U.S. DIRECTORS' DUTIES: A DECISION MANIFESTO**

As noted above, the concept of statutory fiduciary duties for corporate directors is not new. Indeed, most states have some statutory process for identifying and vetting conflicts of interests, and these "interested director" statutes appear to work well.[46] Directors generally understand what transactions are subject to the prohibition and what steps are necessary to protect those transactions from avoidance. These statutes provide *ex ante* guidance and *ex post* punishment.[47]

Could we use a similar approach with the duty of loyalty more generally? We could expand existing statutory schemes that require U.S. directors to act "in the best interests of the company."[48] As noted above, § 172 of the Companies Act of 2006 actually moved U.K. law away from a standard similar to acting "in the best interests of the company" to the current standard of acting "to promote the success of the company."[49]

Alternatively, we could take a less rigid, more dynamic approach structured to achieve objectives similar to a pure rules-based duty scheme.[50] For

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[45] A 2009 survey of corporate executives by McKinsey & Company identified strengths and weaknesses in corporate decision-making and outcomes. Notably, process and assessment were two of the top three traits associated with strong performers. *See* MCKINSEY & CO., FLAWS IN STRATEGIC DECISION MAKING: MCKINSEY GLOBAL SURVEY RESULTS, Jan. 2009, *available at* http://www.mckinsey.com/insights/strategy/flaws_in_strategic_decision_making_mckinsey_global_survey_results.

[46] *See*, *e.g.*, DEL. CODE ANN. tit. 8, § 144 (2013); MODEL BUS. CORP. ACT § 8.61 (2011).

[47] For a discussion of the directive nature of most positive law, *see, e.g.*, Schlag, *supra* note 25, at 381-84.

[48] *See, e.g.,* MODEL BUS. CORP. ACT §§ 8.30-31 (2011).

[49] *See supra* note 38 and accompanying text.

[50] Admittedly, this is a fine line to walk. The proposed statutory language above tries to draw on the virtues of both traditional rules- and standards-based regulation, but striking the optimal balance is more art than science. *See, e.g.,* Schlag, *supra* note 25, at 399-425 (analyzing the virtues and vices explanation of the rules versus standards dichotomy). Like many corporate laws,

example, state corporate laws could incorporate the concept of a board "decision manifesto." These proposed provisions could require a board, in making any material decision in such capacity, to consider, at a minimum, the following factors and certify its deliberations on each factor—or explain why such deliberations were not relevant to the particular transaction or issue before the board—in its meeting minutes or other appropriate document:

- All reasonably available information relating to the proposed transaction(s) or issue(s) before the board;
- The company's internal protocols and policies, if any, relevant to the proposed transaction(s) or issue(s) before the board;
- Discussions with individuals, including responsible or affected senior managers/employees (not just the executive team), who hold material information or experience relevant to the proposed transaction(s) or issue(s) before the board;
- Information concerning the company's ability to meet its legal, regulatory, and financial obligations in the context of the proposed transaction(s) or issue(s) before the board;
- Potential alternatives to the proposed transaction(s) or issue(s) considered the board;
- All reasonably available competing considerations or contrary evidence concerning the proposed transaction(s) or issue(s) before the board;[51]
- The quality of the board's deliberations, including the identification and consideration of dissenting perspectives among directors;[52]

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fiduciary duties and any regulatory schemes we adopt in that context likely will be a hybrid of the traditional rules/standards dichotomy. *See* Cunningham, *supra* note 25.

51 Specifying the need to consider (and for proponents to present) competing evidence and alternative proposals can facilitate more thoughtful decisions.

52 Many commentators stress the value of meaningful (and authentic) dissent during group deliberations. *See, e.g.*, Carsten K. W. DeDreu & Michael A. West, *Minority Dissent and Team Innovation: The Importance of Participation in Decision Making*, 86 J. APPLIED PSYCHOL. 1191, 1191-1201 (2001) (proposing that dissent would predict innovation in teams); Charlan Jeanne Nemeth et al., *Improving Decision Making by Means of Dissent*, 31 J. APPLIED SOC. PSYCHOL. 48, 48-58 (2001) (finding that authentic dissent helped group decision making). This requirement might help companies embrace a culture that permits and attributes value to dissenting and minority viewpoints.

- The long-term impact of the board's decision on the company, including an appropriate cost-benefit analysis;
- Advice of appropriate and qualified outside advisors, unless the potential adverse outcome of the decision is not likely to have a significant impact on the company and the absence of such advisors is disclosed to shareholders; and
- Any potential conflicts of interests or relations relevant to the proposed transaction(s) or issue(s) before the board involving the company's directors, senior executives and managers, shareholders, and/or major creditors.[53]

This type of decision-making blueprint could help boards and, perhaps more importantly, their companies in the midst of considering any material transactions or in any subsequent litigation.

The *ex ante* benefit would stem from the "checklist" nature of the statute. Boards would understand the general expectations for their respective decision-making processes and could adopt protocols tailored to their board's composition and dynamics. Similar to § 172 of the Companies Act of 2006, a decision manifesto statute would not mandate particular outcomes; rather, it simply strives to improve the process in order to help facilitate better decisions.[54] Although largely process-oriented, the elements of this type of statute also could capture concepts under the duty of loyalty such as good faith and monitoring.[55]

Critics likely will argue that this approach is unnecessary given our well-developed jurisprudence on process and the duty of care and that it does nothing more than impose additional requirements on our already overburdened boards. Both of these critiques are understandable and, in fact, were raised in response to

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[53] This element could be structured to complement existing conflict of interest statutes and require the board to certify that the transaction or resolution of the subject issue complies with such statute. *See*, *e.g.*, DEL. CODE ANN. tit. 8, § 144 (2011); MODEL BUS. CORP. ACT § 8.61 (2011).

[54] *See supra* notes 42-43 and accompanying text.

[55] Notably, the duty of loyalty as articulated in § 172 of the Companies Act covers aspects of the duty of loyalty as reconceived by case law incorporating good faith and monitoring into that duty. *See*, *e.g.,* Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006) ("The failure to act in good faith may result in liability because the requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition, 'of the fundamental duty of loyalty.'" (quoting Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003))). The U.K. version of the duty of care does not, in turn, make reference to good faith; rather, it provides in relevant part: "A director of a company must exercise reasonable care, skill and diligence." Companies Act, 2006, c. 46, § 174 (U.K.).

the Companies Act of 2006.[56] Many such critiques question the value of a "check the box" approach to directors' duties.[57] Nevertheless, research suggests that a disciplined process that makes individuals stop and think before deciding can mitigate groupthink dynamics and the risk of rash decisions.[58] The proposed statute also would not displace existing statutory or common law fiduciary duties; rather, it would seek to complement these doctrines and encourage compliance.

The relation between a decision manifesto statute as outlined above and existing doctrines demonstrates the potential *ex post* advantage to the statute: a decision manifesto certifying that the board has considered and deliberated on each of the statutory elements could create an evidentiary presumption in the board's favor in any subsequent litigation.[59] The presumption would be akin to the business judgment rule but would be slightly broader and better defined. A board could issue its decision manifesto (cleansed as necessary to protect the company's confidential and proprietary information) in connection with announcing the board's decision on the transaction or issue in question. A qualifying decision manifesto would not preclude subsequent litigation but it could streamline the process significantly. For example, state law could provide

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[56] *See* Arden, *supra* note 32, at 165 (explaining primary contentions of opponents to the Companies Act of 2006).

[57] *See* Arden, *supra* note 32, at 165, 170 (discussing opposition to the duty of loyalty formulation under § 172 of the Companies Act of 2006, including "that it would create a 'tick-box mentality' rather than encourage meaningful corporate governance"). Arden responds to this criticism as follows: "The advantage of the new statement of the duty is that it reminds directors when making decisions to do what is now best practice, that is to look to the longer term and to the effect of their decisions on the relationships which matter to the company." *Id.* at 170. For a thoughtful discussion of one potential cost to judicial (or statutory) "reminders" to directors, *see* Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139, 1155 (2013) (discussing the transaction costs associated with professional opinions and observing, "I do not deny that a reminder of their duties in the boardroom may have tangible salutary value, but there is unquestionably a cost-benefit consideration attached to the provisions of legal and financial opinions when the preaching of aspirational norms are made to be a necessary transaction cost.").

[58] *See supra* notes 44-45 and accompanying text.

[59] An earlier version of this essay suggested creating a safe harbor for a board that uses and certifies a qualifying decision manifesto. Such a safe harbor, however, might undercut the value to the meaningful deliberation objective underlying the manifesto proposal, turning the exercise into a true "check-the-box" exercise. A rebuttable presumption rewards the board's process and deliberation but retains the potential threat of litigation and liability that should encourage board to take the process seriously. Again, this balance is similar to that achieved in the context of the business judgment rule but applies more broadly and provides greater clarity and guidance to directors.

that a qualifying decision manifesto creates a presumption that the board complied with its fiduciary duties and such presumption can be rebutted only upon a showing of fraud, misrepresentation, or illegality relating to the manifesto or the underlying transaction or issue.[60]

Some commentators may question the breadth of this proposed presumption. On balance, however, the strength of the presumption is warranted to encourage meaningful compliance with the manifesto statute and to focus boards on the role they now serve—monitors of those managing the corporation. To that end, the manifesto statute would not protect officers or other managers responsible for the actual design and implementation of most decisions affecting the day-to-day operations of the company.[61] It also would not protect bad actors—those acting in a fraudulent or illegal manner—on boards.[62] Existing fiduciary duties, federal securities law, and common law would still apply to that conduct. Perhaps redirecting our focus to those laws and those actors would improve enforcement. Regardless, the manifesto statute has little downside but, from a pure governance and decision-making standpoint, great potential upside.

Let us return, once more, to our director who is facing a liquidity crisis at her company. A decision manifesto would not present her with a quick and easy solution, but it would provide her a path to follow and peace of mind that she is using best practices, which would be a safeguard against meritless litigation. Although she likely could avoid liability under the presumption of the business judgment rule, that achievement would come only after litigation (potentially protracted) that included hazy allegations of mere negligence and bad business decisions. Checking the boxes required in a qualifying manifesto would obligate her and her colleagues to take pause and reflect before acting. They might still get it wrong, but the manifesto would help ensure appropriate consideration of reasonable alternatives and an informed judgment. I do not think we can or should ask more of directors.

[60] A qualifying manifesto that satisfies, at a minimum, all of the proposed statutory factors would address and moot the elements of basic duty of care and loyalty claims. Accordingly, it should provide greater and more certain protection for directors, but it should not protect bad actors, which underlies the carveout for fraud, misrepresentation, and illegality.

[61] *See supra* notes 11-14 and accompanying text.

[62] *See supra* notes 59-60 and accompanying text.