HOW MANY FIDUCIARY DUTIES ARE THERE IN CORPORATE LAW?

JULIAN VELASCO*

ABSTRACT

Historically, there existed two main fiduciary duties in corporate law, care and loyalty, and only violations of the duty of loyalty were likely to lead to liability. In the 1980s and 1990s, the Delaware Supreme Court breathed life into the duty of care, created a number of intermediate standards of review, elevated the duty of good faith to equal standing with care and loyalty, and announced a unified test for review of breaches of fiduciary duty. The law, which once seemed so straightforward, suddenly became elaborate and complex. In 2006, in the case of Stone v. Ritter*, the Delaware Supreme Court rejected the triadic formulation and declared that good faith was a component of the duty of loyalty. In this and other respects, Delaware seems to be returning to a bifurcated understanding of the law of fiduciary duties. I believe that this is a mistake. This area of law is inherently complex and much too important to be oversimplified.*

The current academic debate on the issue focuses on whether there should be two duties or three. In this Article, I argue that the question is misleading and irrelevant, but that if it must be asked, the best answer is that there are five duties—one for each paradigm of enforcement. In defending this claim, I explain the true nature of fiduciary duties and provide a robust framework for the discussion, implementation, and development of the law.

* Associate Professor of Law, Notre Dame Law School; B.S. 1991, Georgetown University; J.D. 1994, Columbia University. I would like to thank Matt Barrett, Lisa Casey, Deborah DeMott, Lyman Johnson, Brett McDonnell, and David Millon for their thoughts and comments; and Shelby Lile and Christopher Nichols for their excellent student assistance.

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I. INTRODUCTION

Historically, the law of fiduciary duties was fairly simple, at least with respect to corporate directors.[1] There were two main duties: the duty of

1. I am limiting the discussion to directors in order to avoid the possibly thorny issue of the extent to which fiduciary duties and the business judgment rule apply to corporate officers. *See* Gantler v. Stephens, 965 A.2d 695, 708–09 & n.37 (Del. 2009) (holding that officers have the same fiduciary duties as directors, but noting that the consequences are not necessarily the same). *Compare* Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439 (2005) (arguing why, according to agency theory, the protection of the business judgment rule should not extend to

care and the duty of loyalty. Alleged breaches of the duty of care were protected by the business judgment rule; alleged breaches of the duty of loyalty were reviewed under the entire fairness test. Only violations of the duty of loyalty were likely to lead to liability.

The current state of the law is significantly more complex. The Delaware courts, in particular, have been busy actively rethinking the law of fiduciary duties on many different fronts. In 1985, in the landmark case *Smith v. Van Gorkom*, the Delaware Supreme Court shocked the legal and business communities by holding directors liable for breaching the duty of care even though many did not consider their conduct inappropriate.[2] At around the same time, the court began to announce a number of intermediate standards of review for situations in which neither the business judgment rule nor the entire fairness test seemed appropriate.[3] In 1993, in the case of *Cede & Co. v. Technicolor, Inc.*,[4] the Delaware Supreme Court made two additional announcements. The first was that, rather than being bifurcated, the law of fiduciary duties actually was divided into three branches, with good faith joining care and loyalty in a triad of fiduciary duties. The second was that enforcement of fiduciary duties would be subject to a unified test, with both the business judgment rule and a fairness inquiry having application in every case.[5] Subsequently,

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corporate officers), *and* Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597 (2005) (discussing the application of agency theory to officer-director relationships to establish appropriate fiduciary duties for officers that are different from those of directors), *with* Gregory Scott Crespi, *Should the Business Judgment Rule Apply to Corporate Officers, and Does It Matter?*, 31 OKLA. CITY U. L. REV. 237 (2006) (arguing that the protection of the business judgment rule should be extended to officers in derivative shareholder lawsuits opposed by the board but not in claims initiated by the board or supported by the board), *and* Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865 (2005) (arguing that the protection of the business judgment rule should apply with equal force to both officers and directors).

2. Smith v. Van Gorkom, 488 A.2d 858, 872–73, 893 (Del. 1985) (holding directors liable for breach of the duty of care), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

3. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182, 184 (Del. 1986) (holding that, in situations where a break up of the company or a change of control becomes inevitable, directors have a duty to maximize shareholder value); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that directors' actions to resist a hostile takeover will be upheld only if there are reasonable grounds to believe that the offer poses a threat and the response is reasonable in relation to the threat); Zapata Corp. v. Maldonado, 430 A.2d 779, 788–89 (Del. 1981) (holding that a motion to dismiss shareholder litigation made by a committee of the board of directors will be upheld only if the independence and good faith of the committee are established and the motion comports to the court's independent business judgment).

4. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

5. *Id.* at 361.

in *In re The Walt Disney Co. Derivative Litigation*, the Delaware courts began to breathe life into the duty of good faith.[6] Fiduciary duties, which once seemed so straightforward, suddenly became elaborate and complex.[7]

It is not surprising, then, to find that many scholars and jurists have been seeking to return the law of fiduciary duties to greater simplicity. One manifestation of this movement is rebifurcation. In the 2006 case *Stone ex rel. AmSouth Bancorporation v. Ritter*, the Delaware Supreme Court rejected the triadic formulation of fiduciary duties and declared that the duty of good faith was actually a component of the duty of loyalty.[8] Moreover, one could argue that, over time, the various intermediate standards of review have been watered down to the point where they provide little more scrutiny than the business judgment rule.[9] Delaware seems to be returning to a bifurcated understanding of the law of fiduciary duties—a move which surely would be applauded by many.

I believe that rebifurcation would be a mistake. The law of fiduciary duties is inherently complex and much too important to be oversimplified. Clarification is important, and some pruning may be necessary. Nevertheless, if fiduciary duties are to serve their purpose of protecting shareholders, the law must preserve the nuance and precision that has developed over the years.

The benefit of bifurcation is that it can distinguish situations that are likely to lead to liability from those that are not. Although this is a valid distinction, it is not the only relevant difference among fiduciary duties. A more meaningful distinction would focus on the standards of review that the courts employ to adjudicate allegations of breach. This would say more about the issues involved than just the bottom line.

There are at least five different paradigms for the enforcement of

6. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 62–68 (Del. 2006) (outlining the concept of good faith); *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005) (holding that the plaintiff can establish lack of good faith on the part of a director by proving "intentional dereliction of duty" or "conscious disregard for one's responsibilities"), *aff'd*, *Disney*, 906 A.2d 27.

7. There are other ways in which Delaware complicated the law of fiduciary duties as well. For example, the Delaware Supreme Court has decided that director exculpation charter provisions should be interpreted as an affirmative defense rather than as a bar to liability. *See* Emerald Partners v. Berlin, 726 A.2d 1215, 1223–24 (Del. 1999). Such complications are not directly relevant to this paper.

8. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

9. *See* Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381, 423 (2002).

fiduciary duties.[10] The first two are obvious, and roughly correspond to the duties of care and loyalty. The decisionmaking process is reviewed under a lenient gross negligence standard, and conflicts of interest are reviewed under a demanding entire fairness standard. Because these standards of review are so divergent, it was inevitable that one or more intermediate tests would develop. The third paradigm is the result. The Delaware courts have created a number of intermediate standards of review to deal with structural bias in corporate transactions. These tests can be lumped together under the concept of reasonableness. The fourth paradigm deals with intentional misconduct. This is qualitatively different from carelessness, conflict, or bias. Misconduct is reviewed under a deferential intent standard. The fifth paradigm deals with the business decisions themselves. Claims rooted in the substance of business decisions are reviewed under the most deferential standard of all: irrationality or waste.

These five paradigms represent the irreducible minimum level of complexity necessary to capture the nuance of the law of fiduciary duty. Thus, the law cannot be reduced adequately to two branches. A more practical solution would be to say that there are five fiduciary duties. These duties can be organized as follows[11]:

TABLE. Five Paradigms for the Enforcement of Fiduciary Duties

Fiduciary Duty	*Scope*	*Standard of Review*
care	process	gross negligence
loyalty	conflicts	entire fairness
objectivity	bias	reasonableness
good faith	misconduct	intent
rationality	substance	waste

Of course, the specific taxonomy is not important. As long as it is acknowledged that there are at least five different paradigms for enforcement, it does not matter whether the law says that there are five fiduciary duties, or three, or two, or even only one. Each statement has

10. A paradigm for enforcement is somewhat different from a standard of review. It is an approach to judicial review and may comprise a number of related tests. These five paradigms are described in detail in Part II.

11. The labels care, loyalty, and good faith are familiar to corporate law. I have taken the liberty of naming the two additional duties "objectivity" and "rationality."

some truth to it. A statement that is true in one respect, however, may be inadequate in other respects. Thus, the question—How many fiduciary duties are there in corporate law?—is misleading and ultimately irrelevant. My claim is not that there are five fiduciary duties, but rather that, if the question must be asked, the best answer is five. Moreover, I maintain that it is important to clarify the issue so that a simplistic structure does not lead to the oversimplification of content.

In Part II, I detail the five paradigms for enforcement. In Part III, I evaluate the *Stone* decision to rebifurcate fiduciary duties through the lens of academic debate. I focus primarily on the exchange between Delaware Vice Chancellor Leo Strine and Melvin Eisenberg.[12] This debate relies heavily on semantic argumentation. After demonstrating that semantic arguments do not support subsuming the duty of good faith within the duty of loyalty, I conclude that determinations about the nature of fiduciary duties should not turn on semantics. In Part IV, I set forth a new approach for thinking about fiduciary duties. I begin with the concept of levels of abstraction proposed by Claire Hill and Brett McDonnell,[13] but develop the concept very differently. I argue that it is more meaningful and productive to view fiduciary duties at the level of paradigms for enforcement than at the more abstract level of potential for liability. I also demonstrate that fiduciary duties are highly interrelated, such that there is significant overlap among them. As a result, fiduciary duties cannot be said to lie on a single linear continuum from which simple conclusions can be drawn. Finally, I argue that the various fiduciary duties reflect different aspects of the one fundamental fiduciary duty—to pursue the interests of the corporation and its shareholders—and that, for purposes of litigation, a fiduciary duty corresponds not to director conduct, but to the shareholders' concerns about the conduct and the evidence they can offer. Thus, every action taken by a

12. *See* Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629 (2010). For additional work on the duty of good faith, see, for example, Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559 (2008); Carter G. Bishop, *Directorial Abdication and the Taxonomic Role of Good Faith in Delaware Corporate Law*, 2007 MICH. ST. L. REV. 905 (2007); Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131 (2006); Elizabeth A. Nowicki, *Not in Good Faith*, 60 SMU L. REV. 441 (2007); David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491 (2004); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004); Hillary A. Sale, *Monitoring* Caremark*'s Good Faith*, 32 DEL. J. CORP. L. 719 (2007).

13. *See* Claire A. Hill & Brett H. McDonnell, Stone v. Ritter *and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1788–91 (2007).

director implicates each fiduciary duty and can breach any or all of them depending on the circumstances. Throughout Part IV, I am not advocating for any change in law. Rather, I am merely seeking to develop a better understanding of existing law. In Part V, I consider the impact of *Cede & Co.*'s unified test for breach of fiduciary duty on my theory. I argue that my theory can work well within that framework, but that it would be better for Delaware to return to a more traditional model in which the various standards of review are independent of each other. In this respect, I am recommending a change in law. I conclude in Part VI.

II. THE FIVE PARADIGMS

The debate about the number of fiduciary duties in corporate law has focused on whether there should be two duties or three. Currently, the courts seem to favor bifurcation over a triadic formulation. Thus, a claim that there may be five fiduciary duties would seem to be highly problematic. I will begin laying the groundwork for the argument with a claim that should be much less controversial. In this part, I will demonstrate that there are at least five paradigms for the enforcement of fiduciary duties. A paradigm for enforcement is somewhat different from a standard of review. It is an approach to judicial review and may comprise a number of related tests. There are more than five standards of review in corporate law. Thus, it is possible to argue that there are more than five paradigms for enforcement. I believe, however, that five represents the irreducible minimum, and that it adequately reflects the richness and nuance of existing law.

Sections A and B cover the two most familiar paradigms. The first is the paradigm for review of the decisionmaking process, or the business judgment rule. The second is the paradigm for review of conflicts of interest, or the entire fairness test. Section C covers the third paradigm. Issues of structural bias invoke a number of intermediate standards of review that attempt to assess reasonableness. Section D covers the fourth paradigm. The emerging duty of good faith employs an intentional misconduct standard. Section E covers the fifth and final paradigm. The substance of business decisions is reviewed under a waste standard. Finally, Section F closes with a short discussion of the implications of exculpation charter provisions to the discussion.

A. PROCESS (GROSS NEGLIGENCE)

The first paradigm covers what is normally meant by the duty of care:

the decisionmaking process.[14] Under the duty of care, "directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances."[15] More specifically, "directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties."[16]

While this language adequately describes the duty of care, it does a poor job of describing the first paradigm of enforcement. In order to understand the enforcement of the duty of care, one must understand the business judgment rule. The most common definition of the business judgment rule is that it "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[17] The Delaware courts have explained:

> The rule operates as both a procedural guide for litigants and a substantive rule of law. As a rule of evidence, it creates a presumption . . . . If the proponent [of a claim] fails to meet her burden of establishing facts rebutting the presumption, the business judgment rule, as a substantive rule of law, will attach to protect the directors and the decisions they make.[18]

This characterization of the business judgment rule is inadequate and does more to confuse matters than to clarify them. In simpler terms, the business judgment rule can be characterized as a standard of review that corresponds to the duty of care.[19] Confusingly, standards of review do not always match standards of conduct in corporate law.[20] In Delaware, "under

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14. I use the term "decisionmaking process" in the broadest sense possible. It includes the process related to all board endeavors, whether in the nature of management or monitoring.

15. Graham *ex rel.* S'holders of Allis-Chalmers Mfg. Co. v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963). *See also* MODEL BUS. CORP. ACT § 8.30(b) (2005) ("The members of the board of directors . . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.").

16. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

17. *Id.*

18. Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989) (internal quotation marks omitted).

19. *See* Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 828–29 (2004). *Cf.* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 89–90 (2004) (arguing that the business judgement rule is best understood as an "abstention doctrine" that creates a presumption against duty of care claims).

20. *See* MODEL BUS. CORP. ACT § 8.31 official cmt.; Melvin Aron Eisenberg, *The Divergence of*

the business judgment rule director liability is predicated upon concepts of gross negligence."[21] Thus, while the duty of care demands that directors avoid negligence, the business judgment rule provides that directors will be held accountable for breaching the duty of care only if they are grossly negligent. Although the distinction between negligence and gross negligence may be difficult to articulate,[22] gross negligence involves conduct that is significantly more culpable than negligence; conduct that can be characterized as extremely negligent, as opposed to barely negligent.[23]

Thus, the first paradigm for the enforcement of fiduciary duties is that the directors' decisionmaking process will be reviewed for gross negligence. This is a deferential standard of review. The justification for the laxity is multifaceted.[24] It usually begins with the statutory mandate that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors,"[25] rather than by the shareholders who would challenge their decisions or the courts who would evaluate them.[26] It is also heavily grounded in the recognition that courts lack the expertise to evaluate business decisions, given the infrequency with which they are required to do so and the inherent bias of hindsight.[27] Ultimately, however, it is based largely on the insight that, "as a general matter, directors can be trusted and need not be policed very closely,"[28] at least unless there is some reason to doubt them.

B. CONFLICTS (FAIRNESS)

The second paradigm covers what is traditionally meant by the duty of

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Standards of Conduct and Standards of Review in Corporate Law, 62 FORDHAM L. REV. 437 (1993).

21. *Aronson*, 473 A.2d at 812.

22. *See* Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 658 n.56 (2002) ("It has long been debated whether there is a difference between 'negligence' and 'gross negligence.'").

23. *See* BLACK'S LAW DICTIONARY 1134 (9th ed. 2009) (defining "gross negligence").

24. For a more thorough discussion, see Velasco, *supra* note 19, at 830–34.

25. DEL. CODE ANN. tit. 8, § 141(a) (2010).

26. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors."), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

27. *See* Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982) ("[C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions."); Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979) ("[T]he business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments.").

28. Velasco, *supra* note 19, at 834.

loyalty: conflicts of interest. "If the key insight of the business judgment rule is that directors generally can be trusted, the key insight of the entire fairness test is that this is not always so."[29] *Guth v. Loft, Inc.* is often cited as providing the classic statement of the duty of loyalty:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.[30]

Once again, this is more a description of the duty of loyalty than of the second paradigm of enforcement. In order to understand the enforcement of the duty of loyalty, one must understand the entire fairness test. At first glance, the standard of review and the standard of conduct associated with the duty of loyalty seem closely aligned.[31] Closer inspection, however, reveals that there is a significant divergence in some respects.

Taken to its logical conclusion, the duty of loyalty could require that directors never have any conflicts of interest. Essentially, that was once the state of the law.[32] Over time, however, the law developed to the point where it stands today: directors are allowed to engage in interested transactions, provided that the transactions are sanitized by the approval of either fully informed directors or shareholders ex ante, or the courts ex

29. *Id.*

30. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). For another classic statement, see *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (discussing the fiduciary duty of loyalty among partners).

31. *See* Eisenberg, *supra* note 20, at 451 (stating that "the standard of review is the same as the standard of conduct").

32. *See generally* Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966) (discussing the history of legal treatment of conflicts under duty of loyalty).

post.[33] If a transaction is sanitized by director or shareholder approval, it usually is found not to involve a conflict of interest and is reviewed under the business judgment rule; otherwise, it is subject to scrutiny under the entire fairness test.[34]

The entire fairness test has both a procedural and a substantive component. According to the Delaware Supreme Court:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed [transaction], including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. . . . However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.[35]

The deference that is the hallmark of the business judgment rule is entirely absent under the entire fairness test. Not only do directors bear the burden of proof, but they also must justify both their decisionmaking process and the substance of their decisions. It would seem that the business judgment rule and the entire fairness test could not be much more

33. *See* DEL. CODE ANN. tit. 8, § 144 (2010); MODEL BUS. CORP. ACT § 8.61 (2005); Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976) ("We do not read the statute as providing . . . broad immunity . . . . It merely removes an 'interested director' cloud when its terms are met . . . . Nothing in the statute sanctions unfairness . . . or removes the transaction from judicial scrutiny.").

34. *See, e.g.*, Marciano v. Nakash, 535 A.2d 400, 405 n.3 (Del. 1987) ("[A]pproval by fully-informed disinterested directors under section 144(a)(1), or disinterested stockholders under section 144(a)(2), permits invocation of the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction."); *In re* The Walt Disney Co. Derivative Litig., 731 A.2d 342, 368 (Del. Ch. 1998) ("[O]ur courts have treated fully informed shareholder ratification under § 144(a)(2) as validating the transaction and removing it from the purview of entire fairness review. The business judgment rule applies to the ratified transaction . . . ." (footnote omitted)), *aff'd in part*, *rev'd in part sub nom.* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

To be fair, there is an additional layer of complexity when a controlling shareholder is involved. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) ("[A]n approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness . . . ."). I have not included this in the discussion in the text for two reasons. First, although it complicates the discussion, it does not change much. As I have made clear, a paradigm for enforcement can include multiple standards of review. Second, I believe the situation involves structural bias–type concerns and might be better placed in the third paradigm for enforcement. *See* Velasco, *supra* note 19, at 851–53.

35. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (citations omitted).

divergent. In fact, it has been said that "the determination of the appropriate standard of judicial review frequently is determinative of the outcome."[36]

And yet, the entire fairness test is not quite as demanding as could be imagined. It is not actually outcome-determinative.[37] Nor does the test require the directors to prove that their decision was perfect.[38] Moreover, the test has only limited applicability. Despite the broad language with which the courts often describe the duty of loyalty, the entire fairness test is not applied to all director conflicts. It is only applied to those that "rise to the level of self-dealing."[39] "Classic examples of [self-dealing] involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally."[40]

Actual self-dealing is not necessarily required, provided that the conflict rises to the same level substantively. However, many types of conflict that a layperson might think would compromise a director's objectivity are not deemed to rise to the level of self-dealing. The most obvious is friendship and collegiality among the directors on a board.[41] The courts have rejected such claims even in extreme circumstances.[42]

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36. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989) (quoting AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986)).

37. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995) ("[A]n initial judicial determination that a given breach of a board's fiduciary duties has rebutted the presumption of the business judgment rule does not preclude a subsequent judicial determination that the board action was entirely fair, and is, therefore, not outcome-determinative *per se*."); Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("Application of the entire fairness rule does not, however, always implicate liability of the conflicted corporate decisionmaker, nor does it necessarily render the decision void.").

38. *See Cinerama*, 663 A.2d at 1179 ("A finding of perfection is not a *sine qua non* in an entire fairness analysis."); *Weinberger*, 457 A.2d at 709 n.7 (stating that "perfection is not possible, or expected").

39. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 363 (Del. 1993) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000)). *See also* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. This alone will not evoke the intrinsic fairness standard, however. This standard will be applied only when the fiduciary duty is accompanied by self-dealing . . . .").

40. *Cede & Co.*, 634 A.2d at 362. *See also Sinclair*, 280 A.2d at 720 ("The basic situation for the application of the rule is the one in which the parent has received a benefit to the exclusion and at the expense of the subsidiary.").

41. This is a species of structural bias. *See* Velasco, *supra* note 19, at 856–57.

42. In *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, the Delaware Supreme Court considered the issue in the context of a demand futility claim and stated the following:

> A variety of motivations, including friendship, may influence the demand futility inquiry. But, to render a director unable to consider demand, a relationship must be of a bias-producing nature. . . . Not all friendships, or even most of them, rise to this level and the

Generally, to be cognizable, a conflict must consist of either a personal or familial financial interest. Even so, not all financial conflicts will be sufficient to invoke the entire fairness test. The conflict must be "material."[43] A hypothetical or speculative conflict is insufficient. Even a director's interest in maintaining his position on the board in the face of a hostile takeover may not be sufficient.[44]

A comparison of the standard of conduct and the standard of review for the duty of loyalty reveals that there is significant congruence as well as significant divergence. The standard of conduct is uniformly demanding; the standard of review is not. On the one hand, the standard of review is significantly more limited than the standard of conduct in that it focuses primarily, if not exclusively, on financial conflicts that rise to the level of self-dealing.[45] On the other hand, once this hurdle is cleared, the standard of review is quite exacting in that it requires the directors to carry the burden of proof on the issue of fairness. In other words, the shareholders do not have to prove any actual wrongdoing, but only a cognizable conflict of interest, and then the directors must prove that they have done nothing wrong.[46]

> Court cannot make a *reasonable* inference that a particular friendship does so without specific factual allegations to support such a conclusion.

Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1050 (Del. 2004) (quoting Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 833 A.2d 961, 979 (Del. Ch. 2003) (footnote omitted)). The facts of the case demonstrate that the quantum of proof required by the court is quite high:

> Allegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' even when coupled with Stewart's 94% voting power, are insufficient, without more, to rebut the presumption of independence. They do not provide a sufficient basis from which reasonably to infer that [the directors in question] may have been beholden to Stewart.

Id. at 1051. On the other hand, the courts have at times accepted claims of bias in much more marginal situations. *See, e.g.*, *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 920–21 (Del. Ch. 2003) (denying a special litigation committee's motion to terminate a derivative lawsuit because members of the special litigation committee—two tenured professors at Stanford University—were required to evaluate the conduct of a fellow professor and two University benefactors).

43. *See Cede & Co.*, 634 A.2d at 364 ("A trial court must have flexibility in determining whether an officer's or director's interest in a challenged board-approved transaction is sufficiently material to find the director to have breached his duty of loyalty and to have infected the board's decision.").

44. *See* Am. Gen. Corp. v. Unitrin, Inc. (*In re* Unitrin, Inc. S'holders Litig.), Nos. 13656, 13699, 1994 Del. Ch. LEXIS 187, at *13 (Del. Ch. Oct. 13, 1994) ("The board's interest in employing these defensive measures to deflect [a hostile] offer does not rise to the level of a self-dealing transaction that requires the board to demonstrate entire fairness."), *rev'd on other grounds*, 651 A.2d 1361 (Del. 1995); City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 790 n.1 (Del. Ch. 1988).

45. This is an issue of some debate. *See infra* notes 152–56 and accompanying text. The second paradigm of judicial enforcement, as I see it, deals almost exclusively with financial conflicts.

46. *See* Velasco, *supra* note 19, at 835.

Thus, the second paradigm for the enforcement of fiduciary duties is that directors are required to defend their actions whenever there is a conflict that rises to the level of self-dealing. This is a demanding standard of review that is reserved for special circumstances. The justification is that when directors are conflicted they cannot be trusted to pursue the interests of the shareholders over their own.[47] The problem is that, even assuming that the directors would not be dishonest by consciously favoring their own interests, there may be situations when they are unable to pursue shareholder interests as zealously as the shareholders deserve. For this reason the courts provide shareholders with an impartial review.[48]

C. BIAS (REASONABLENESS)

The third paradigm comprises a number of different standards of review that deal with essentially the same problem: structural bias.

> The term "structural bias" generally refers to the prejudice that members of the board of directors may have in favor of one another and of management. It is said to be the result of the "common cultural bond" and "natural empathy and collegiality" shared by most directors, the "economic[] or psychological[] dependen[cy] upon or tie[s] to the corporation's executives, particularly its chief executive," and the "process of director selection and socialization, which incumbent management dominates."[49]

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47. *See* 2 MODEL BUS. CORP. ACT § 8.60 Subchapter F, introductory cmt., at 8-372 (2002) ("The law regulates interest-conflict transactions because experience shows that people do often yield to the temptation to advance their self-interests and, if they do, other people may be injured. That contingent fear is sufficient reason to warrant caution and to apply special standards and procedures to interest-conflict transactions."); FRANKLIN A. GEVURTZ, CORPORATION LAW 325 (2000) ("[T]he fundamental problem with conflict-of-interest transactions is that we do not trust individuals with a personal financial stake at odds with the corporation's to put the corporation's interest ahead of their own."); Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 663 (Del. 1952) ("Human nature being what it is, the law, in its wisdom, does not presume that directors will be competent judges of the fair treatment of their company where fairness must be at their own personal expense.").

48. *See* Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("The entire fairness analysis essentially requires 'judicial scrutiny.' In business judgment rule cases, an essential element is the fact that there has been a business decision made by a disinterested and independent corporate decisionmaker. When there is no independent corporate decisionmaker, the court may become the objective arbiter." (citations omitted) (footnote omitted)); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) ("[W]hen a transaction is one involving a predominately interested board with a financial interest in the transaction adverse to the corporation . . . there is no alternative to a judicial evaluation of the fairness of the terms of the transaction other than the unacceptable one of leaving shareholders unprotected.").

49. Velasco, *supra* note 19, at 824 (footnotes omitted) (quoting James D. Cox, *Searching for the Corporation's Voice in Derivative Litigation: A Critique of* Zapata *and the ALI Project*, 1982 DUKE L.J.

Structural bias is a form of conflict, but not one that courts deem cognizable under the duty of loyalty.[50] This is understandable: "[I]f structural bias were accepted as a conflict of interest, . . . many issues that are deemed to involve the duty of care might be considered to involve the duty of loyalty. If so, the entire fairness test would swamp the business judgment rule."[51] This would be inappropriate. Nevertheless, the concern that structural bias affects the independence of directors is legitimate and, as a result, "the deference of the business judgment rule seems as inadequate as the rigor of the entire fairness test seems excessive."[52]

Despite sometimes being resistant to, or even dismissive of, claims of structural bias,[53] the Delaware courts have dealt with the problem in a number of different circumstances.[54] They have done so by developing intermediate standards of review when neither the business judgment rule nor the entire fairness test seemed appropriate. The two most significant circumstances the courts have addressed are takeover defense and board review of shareholder derivative litigation.[55]

959, 962; MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 145 (1976); and John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 283 (1981) (alterations in original)). *See also* Claire A. Hill & Brett H. McDonnell, Disney*, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 853–54 (2007).

50. *See* Velasco, *supra* note 19, at 914 ("[A]lthough structural bias may seem to involve the duty of loyalty, it does not necessarily involve a *breach* of the duty of loyalty."). Perhaps it would be more accurate to say that structural bias does not fall within the second paradigm for enforcement of fiduciary duties. Delaware courts allow for the possibility that friendship might, in an appropriate case, undermine a director's independence. In their view, however, that would be a rare case. *See* cases cited *supra* note 42. Courts demand specific proof. *See* Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1051–52 (Del. 2004) ("Mere allegations that they move in the same business and social circles, or a characterization that they are close friends, is not enough to negate independence . . . ."); Aronson v. Lewis, 473 A.2d 805, 815 n.8 (Del. 1984) ("The difficulty with structural bias . . . is simply one of establishing it in the complaint . . . . We are satisfied that discretionary review by the Court of Chancery of complaints alleging specific facts pointing to bias on a particular board will be sufficient . . . ."), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000). This language is inconsistent with the structural bias claim that, in such relationships, bias is inherent. Because structural bias is by definition a subtle influence, the requirement that the shareholders provide proof is essentially a rejection of the argument. In any event, the requirement that shareholders bear such a heavy burden of proof is incompatible with the second paradigm that places the burden of proof on the directors.

51. Velasco, *supra* note 19, at 844–45.

52. *Id.* at 840.

53. *Id.* at 841–45.

54. *See id.* at 845–52.

55. A third possibility would be conflicts of interest when a controlling shareholder is involved. *See supra* note 34.

In *Unocal Corp. v. Mesa Petroleum Co.*, the court recognized that, in circumstances involving a hostile takeover, there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[56] In response, the court recognized "an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[57] That threshold inquiry was a new intermediate standard of review. First, "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[58] Second, the defensive measures "must be reasonable in relation to the threat posed."[59] At the time, this seemed to be a reasonable attempt to balance the various competing concerns. Unfortunately, subsequent developments have demonstrated that the *Unocal* test is not as demanding as its language might suggest, and I have argued elsewhere that it now provides little more protection than the business judgment rule.[60]

In *Zapata Corp. v. Maldonado*, the court recognized that, in situations where a board of directors decides to oppose derivative litigation, "there is sufficient risk in the realities of [the] situation . . . to justify caution beyond the adherence to the theory of business judgment."[61] In response, the Delaware Supreme Court reserved the right to reject a board or committee's decision if the circumstances warrant.[62] Again, the court did so in the form of a new, two-part test. "First, the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions. . . . The corporation should have the burden of

56. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

57. *Id.*

58. *Id.* at 955.

59. *Id.*

60. *See* Velasco, *supra* note 9, at 416–22; Velasco, *supra* note 19, at 846–47.

61. Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981). In particular:

> [W]e must be mindful that directors are passing judgment on fellow directors in the same corporation and fellow directors, in this instance, who designated them to serve both as directors and committee members. The question naturally arises whether a "there but for the grace of God go I" empathy might not play a role. And the further question arises whether inquiry as to independence, good faith and reasonable investigation is sufficient safeguard against abuse, perhaps subconscious abuse.

Id.

62. *Id.* at 788. The court justified its decision on the following basis:

> We recognize the danger of judicial overreaching but the alternatives seem to us to be outweighed by the fresh view of a judicial outsider. Moreover, if we failed to balance all the interests involved, we would in the name of practicality and judicial economy foreclose a judicial decision on the merits. At this point, we are not convinced that is necessary or desirable.

Id.

pro[of] . . . ."[63] Second, "The Court should determine, applying its own independent business judgment, whether the motion should be granted."[64] This result is somewhat out of place in corporate law, where judicial incompetence to make business decisions is one of the key justifications of the business judgment rule.[65] Nevertheless, this reserved power to overrule directors' decisions based entirely on the courts' own assessment of the merits has not had much of an impact on litigation.[66]

These are the two main intermediate standards of review. Others could be identified.[67] Unfortunately, Delaware has dealt with these problems in an ad hoc manner. In earlier work, I have argued that a common approach to the problem of structural bias would be preferable.[68] My proposal called for a moderate review of the substance of directors' decisions: in cases involving structural bias, the shareholders would be able to prevail by establishing that the directors' decisions were unreasonable.[69] This reasonableness standard may seem reminiscent of the *Unocal* standard, but actually is quite different:

> Aware of structural bias, the courts should not be overly concerned with substituting their own business judgment for that of conflicted directors. They should, with confidence, determine whether the decision in question was unreasonable under the circumstances. The only deference

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63. *Id.*

64. *Id.* at 789.

65. *See supra* note 27 and accompanying text.

66. *See* GEVURTZ, *supra* note 47, at 434 ("The fact that there have been no reported major trials to apply the *Zapata* approach raises questions as to whether courts or litigants ever will be serious about obtaining an independent judicial evaluation of the corporation's interest.").

67. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[When] the break-up of the company [becomes] inevitable . . . [t]he directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."); Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (holding that the test for demand futility involves "two inquiries, one into the independence and disinterestedness of the directors and the other into the substantive nature of the challenged transaction and the board's approval thereof"), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659–61 (Del. Ch. 1988) (noting that "a decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote" requires that the board "bear[] the heavy burden of demonstrating a compelling justification for such action"); Velasco, *supra* note 19, at 851–53 (characterizing shifts in the burden of proof on the issue of fairness as an intermediate standard of review). *Cf.* Velasco, *supra* note 19, at 847–49 n.111 (discussing whether *Revlon* and *Blasius* should be seen as separate tests, or as part of *Unocal*).

68. *See generally* Velasco, *supra* note 19 (proposing an intermediate standard of review for cases involving structural bias that would balance directorial authority and accountability).

69. *Id.* at 876. Under my proposed standard, a reasonable decision would be "one that a prudent and impartial decision maker could realistically—as opposed to merely hypothetically—consider wise." *Id*. at 877.

> that courts should show would come from the breadth of the term "reasonable"—which is significant, but not boundless. The extreme deference that would normally be afforded to directors under the business judgment rule should not apply.[70]

As I have argued, such a standard would "strike a balance between the deference of the business judgment rule and the rigor of the entire fairness test"[71] by providing judicial review that is "meaningful, but not excessive."[72]

Clearly, the third paradigm of enforcement of fiduciary duties is less well defined than the first two. Nevertheless, a general outline is discernable. Under the *Unocal* test, a court reviews the merits of the board's decisions for reasonableness and proportionality (even if the review is deferential). Under the *Zapata* test, a court may reject the board's decision based entirely on its own business judgment. In other words, the third paradigm provides that, in a situation involving a recognized risk of structural bias, the courts will apply an intermediate standard of review in which the substance of the directors' decision is not beyond scrutiny.[73]

In this Article, I refer to the third paradigm as a test of "reasonableness" for three reasons. First, although there is no single intermediate standard of review, it is grammatically easier to speak as if there were. Second, the term reasonableness conveys a moderate review of substance, which the various standards share. Third, the term reasonableness can easily refer to either the *Unocal* test or my proposed intermediate standard of review. In any event, the approach to fiduciary duties that I propose in this Article works well regardless of the precise contours of the third paradigm.

D. MISCONDUCT (INTENT)

The fourth paradigm covers what is normally meant by the duty of good faith: intentional misconduct.[74] The law not only presumes, but also requires, that directors act in good faith.[75] Various statutory provisions

70. *Id.* at 880.
71. *Id.* at 826.
72. *Id.* at 871.
73. *See id.* at 845–53.
74. I defend this claim *infra* notes 78–86 and accompanying text.
75. *See, e.g.*, Bainbridge, Lopez & Oklan, *supra* note 12, at 563–64 (citing DEL. CODE ANN. tit. 8, § 145 (2001)); Eisenberg, *supra* note 12, at 4.

reflect the importance of good faith in corporation law.[76] For over a decade, the duty of good faith was elevated to a position of equality with duties of care and loyalty in Delaware law.[77] Nevertheless, the duty of good faith has not received much attention until fairly recently.

While it is difficult to pin down the duty of good faith with certainty, Eisenberg has articulated an excellent formulation:

> The duty of good faith in corporate law is comprised of a general baseline conception and specific obligations that instantiate that conception. The baseline conception consists of four elements: subjective honesty, or sincerity; nonviolation of generally accepted standards of decency applicable to the conduct of business; nonviolation of generally accepted basic corporate norms; and fidelity to office. Among the specific obligations that instantiate the baseline conception are the obligation not to knowingly cause the corporation to disobey the law and the obligation of candor even in non-self-interested contexts.[78]

Although one may quibble at the margins, this description captures the essence of the duty of good faith.

One of the leading cases on the issue of good faith is the *Disney* case.[79] There, the Delaware Supreme Court elaborated on the duty of good faith as follows:

> A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.[80]

This account comes closer to describing the standard of review than the standard of conduct. It is much narrower than Eisenberg's standard. Essentially, it provides that shareholders may establish a breach of the duty of good faith by showing intentional misconduct, intentional violation of

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76. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 102(b)(7), 141(e), 144, 145(a)–(b) (2010).

77. Good faith was declared to be part of a triad of fiduciary duties in *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993). It was demoted to a subset of loyalty in *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369–70 (Del. 2006).

78. *See* Eisenberg, *supra* note 12, at 5.

79. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006). The other is *Stone*, 911 A.2d 362.

80. *Disney*, 906 A.2d at 67 (quoting *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005), *aff'd*, 906 A.2d 27); *quoted in Stone*, 911 A.2d at 369.

law, or intentional disregard of duty.

All three of the violations of the duty of good faith identified by the *Disney* court, as well as dishonesty, insincerity, indecency, and infidelity,[81] can be categorized generally as "intentional misconduct," which is the core concern of the fourth paradigm. A breach of the duty of good faith involves conduct that is both intentional and wrongful. There need not be any malice or intent on the part of the director to cause harm, however. As long as there is intentional behavior that the law considers to be misconduct, there is a breach of fiduciary duty. In other words, there is an objective component to good faith.[82] Of course, a subjective intent to harm shareholder interests would suffice; but so would a simple intent to violate the law (even if it were motivated by a desire to benefit the shareholders) as well as intent to shirk responsibility, among other things.

I would argue that, under the fourth paradigm, the shareholders also can establish a breach of fiduciary duty by proving that the directors *intentionally* violated the standard of *conduct* for either the duty of care or the duty of loyalty (or any other duty, for that matter). This is important because of the divergence between standards of conduct and standards of review in corporate law.[83] The standard of conduct for the duty of loyalty may require that directors act only in the interests of the corporation and its shareholders, but (under the second paradigm) the standard of review covers primarily financial conflicts that rise to the level of self-dealing. However, if the shareholders can establish that the directors actually pursued an interest other than those of the corporation and its shareholders (whatever that may be, and whether or not the conflict is financial or rises to the level of self-dealing), that would be actionable under the fourth paradigm. Likewise, the standard of conduct for the duty of care requires that each director act as an ordinarily careful and prudent person in similar circumstances, but the standard of review requires the shareholders to prove that the directors were grossly negligent—and even then, the directors might be exculpated.[84] However, if the shareholders could establish that directors acted *recklessly*—that is, with a "conscious ([or]

81. *See supra* note 78 and accompanying text.

82. Strine insists that good faith is entirely subjective: it is "the state of mind that must motivate a loyal fiduciary." Strine et al., *supra* note 12, at 633. Many scholars disagree. *See, e.g.*, Eisenberg, *supra* note 12, at 23 ("[G]ood faith in law includes objective as well as subjective elements."); Nowicki, *supra* note 12, at 469.

83. *See supra* note 20 and accompanying text.

84. *See infra* Part II.F (discussing statutory exculpation of a director's breach of the fiduciary duty of care).

deliberate) disregard for or indifference to [‘a substantial and unjustifiable’] risk”[85]—that would be actionable under the fourth paradigm.[86]

What happens if the shareholders can establish intentional misconduct? Presumably, an entire fairness inquiry would follow,[87] although that is not entirely free from doubt.[88] I propose that the burden should shift to the directors to establish a compelling justification for their actions. Readers familiar with *Blasius Industries, Inc. v. Atlas Corp*. will no doubt notice a resemblance with the test announced in that case.[89] This is intentional. I believe that the *Blasius* case, at root, involves the duty of good faith rather than care or loyalty.[90]

In *Blasius*, a 9 percent shareholder sought to expand the board of directors of the company from seven to fifteen members and to name eight new directors. In response, the existing directors quickly expanded the size of the board to nine members and appointed two new directors. This was done in order to prevent that shareholder from naming a majority of directors.[91] The court held that whenever directors act for the primary purpose of thwarting a shareholder vote, their actions cannot be upheld without a compelling justification.[92] This is because such action by the board of directors intrudes on the shareholders’ right in corporate governance to elect directors.[93]

The directors’ actions in *Blasius* constituted intentional misconduct. The conduct (appointing new directors) was both intentional (primary purpose) and wrongful (thwarting a shareholder vote).[94] The court believed

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85. BLACK’S LAW DICTIONARY 1385 (9th ed. 2009) (defining “reckless”).

86. If this is correct, then an intentional breach of the duty of care would not be exculpable because it also would be a breach of the duty of good faith. *See infra* notes 322–25 and accompanying text.

87. *See In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006).

88. *See infra* notes 326–30 and accompanying text.

89. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988). The essential holding of *Blasius* has been affirmed by the Delaware Supreme Court. *See* MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003) (“When the *primary purpose* of a board of directors’ defensive measure is to interfere with or impede the effective exercise of the shareholder franchise in a contested election for directors, the board must first demonstrate a compelling justification for such action as a condition precedent to any judicial consideration of reasonableness and proportionately [sic].”).

90. The same point has been made by Andrew Gold. *See* Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 480–83 (2009).

91. *Blasius*, 564 A.2d at 654–56.

92. *Id.* at 661–62.

93. *Id.* at 659–60.

94. In earlier work, I have argued that the *Blasius* test should be extended to cover any director action that has “a significant effect of interference with shareholder democracy.” Julian Velasco, *Taking*

that the directors were acting in subjective good faith (that is, in order to protect the remaining shareholders).[95] Nevertheless, the conduct was inherently wrongful under corporate law given the structure of corporate governance. Rather than rule their behavior illegal per se, however, the court gave the directors the opportunity to prove that they were acting in the best interests of the corporation and its shareholders by establishing a compelling justification for their actions. This is no *intermediate* standard of review. Unlike the third paradigm, shareholders bear a very heavy burden. Moreover, if they meet this burden, the directors bear an even heavier burden to escape liability. This, I believe, is the essence of the fourth paradigm for enforcement—or at least should be.

Thus, the fourth paradigm for the enforcement of fiduciary duties is that the directors will be held accountable for intentional misconduct. It is important to note that the primary burden of proof is on the shareholders, and it is a heavy one. Although malice is not necessary, the shareholders must establish intentional conduct that is wrongful. Once they have done so, the burden shifts to the directors to justify their actions. Because their actions constitute misconduct, the directors should have to establish a compelling justification.[96]

As a final matter, it is worth noting how different the fourth paradigm is from the second. The second paradigm is based on the duty of loyalty and focuses on financial conflicts that rise to the level of self-dealing. Under it, the real burden is on the directors to establish that their behavior was entirely fair to the shareholders. The fourth paradigm is based on the duty of good faith and focuses on intentional misconduct. Under it, the shareholders bear the primary burden of establishing that the directors engaged in intentional misconduct. As standards of review, the two are entirely different.

E. SUBSTANCE (WASTE)

The fifth and final paradigm deals with the substance of business decisions and covers a range of legal concepts, including abuse of

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Shareholder Rights Seriously, 41 U.C. DAVIS L. REV. 605, 658 (2007). I believe that this is consistent with an intentional misconduct test, provided that the shareholders can establish that the directors intentionally took action knowing that significant interference with the shareholder franchise would result.

95. *Blasius*, 564 A.2d at 658.

96. *Cf. infra* notes 336–39 and accompanying text.

discretion, waste, irrationality, and (more recently) substantive care.[97] This paradigm is the most controversial.

One of the most respected jurists in Delaware's history, Chancellor William Allen, took a very strong negative position on the issue in *In re Caremark International, Inc. Derivative Litigation*.[98] According to him,

> [C]ompliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in *a good faith* effort to advance corporate interests.[99]

This position is understandable. The rationale for limited judicial review under the business judgment rule applies with even greater force to the substance of business decisions than to the decisionmaking process.[100] Many scholars believe that the courts should not review the substance of business decisions absent some other breach of fiduciary duty.[101]

Nevertheless, the fact remains that courts generally do reserve the right to review the substance of business decisions, at least in the most extreme cases.[102] For example, in *Brehm v. Eisner*, the Delaware Supreme Court took a very negative position on the issue, but did not reject it altogether:

> As for the plaintiffs' contention that the directors failed to exercise "substantive due care," we should note that such a concept is foreign to the business judgment rule. Courts do not measure, weigh or quantify

97. *See* DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 84–90, 93–97 (5th ed. 1998) (discussing abuse of discretion and waste); Brehm v. Eisner, 746 A.2d 244, 262–66 (Del. 2000) (discussing "substantive due care" and waste).

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

99. *Id.* at 967.

100. *See supra* notes 19–27 and accompanying text.

101. *See, e.g.*, Bainbridge, *supra* note 19, at 90; Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on* Disney, *Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 401 (2007); Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625, 631–32 (2000); D.A. Jeremy Telman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 TUL. L. REV. 829, 830–33 (2007); 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, 1421–24 (2005).

102. *See* BLOCK, BARTON & RADIN, *supra* note 97, at 84–90, 93–97.

> directors' judgments. We do not even decide if they are reasonable in this context. Due care in the decisionmaking context is *process* due care only. Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.[103]

It seems that the courts are unable or unwilling to let go of the concept.[104] This should not provide much comfort to shareholders, however. To establish a breach of fiduciary duty under the fifth paradigm, the shareholders bear the burden of establishing that "[the consideration] the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid."[105] "That is 'an extreme test, very rarely satisfied by a shareholder plaintiff.'"[106]

In light of the foregoing, one has to wonder whether there is any point in having a fifth paradigm. Perhaps it is nothing more than a "theoretical exception."[107] After all, it seems fanciful to suggest that a careful, unconflicted, and unbiased board of directors acting in good faith could come to a decision that no reasonable person could reach.

The fifth paradigm is not merely tilting at windmills, however. It does

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103. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (footnotes omitted). The court also stated that "[t]o be sure, there are outer limits, but they are confined to unconscionable cases where directors irrationally squander or give away corporate assets." *Id*. at 263.

104. *Cf.* David Rosenberg, *Galactic Stupidity and the Business Judgment Rule*, 32 J. CORP. L. 301, 304 (2007) ("Although few courts or commentators are willing to use the term, substantive due care analysis is in fact alive in Delaware fiduciary law, and has been for at least two decades.").

105. Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988) (quoting Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962)), *overruled on other grounds by Brehm*, 746 A.2d at 253. *See also* Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997) ("Roughly, a waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."); Glazer v. Zapata Corp., 658 A.2d 176, 183 (Del. Ch. 1993) ("[T]he legal test [for waste] is severe. Directors are guilty of corporate waste, only when they authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.").

106. Zupnick v. Goizueta, 698 A.2d 384, 387 (Del. Ch. 1997) (quoting Steiner v. Meyerson, No. 13139, 1995 Del. Ch. LEXIS 95, at *3 (Del. Ch. July 19, 1995)). According to Chancellor Allen in *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051–52 (Del. Ch. 1996), "There is a theoretical exception . . . that holds that some decisions may be so 'egregious' that liability for losses they cause may follow . . . . The exception, however, has resulted in no awards of money judgments against corporate officers or directors in this jurisdiction . . . ." *But see* Fidanque v. Am. Maracaibo Co., 92 A.2d 311, 321 (Del. Ch. 1952) ("Since the payment . . . constitutes an illegal gift of corporate funds and amounts to waste, . . . it is therefore null and void.").

107. *Gagliardi*, 683 A.2d at 1051.

not assume that directors who have fulfilled fiduciary duties make utterly irrational decisions. Rather, it assumes only that a director who cannot be *proven* to have breached any other fiduciary duty nevertheless can make a decision that *appears* irrational. However, a decision that would seem irrational from the perspective of a faithful director could be perfectly rational from the perspective of an unfaithful director. Because of the divergence of standards of conduct and standards of review,[108] directors may breach a fiduciary duty without being held accountable. The fact that a shareholder cannot establish gross negligence does not mean that directors were not negligent; the fact that a shareholder cannot establish self-dealing does not mean that directors were not conflicted; the fact that a shareholder cannot establish that a decision was unreasonable does not mean that directors were unbiased; and the fact that a shareholder cannot establish intentional misconduct does not mean that directors were acting in good faith. Thus, the basis for the directors' decision could be misbehavior that otherwise would go unchecked.

In other words, the waste doctrine can be seen as a proxy for breach of other fiduciary duties, especially the duty of good faith.[109] The real principle, then, is not that a decision was so bad that the director should be held responsible. Rather, it is that the decision was so bad that it is reasonable to infer that something is amiss.

Thus, the fifth paradigm for the enforcement of fiduciary duties is that a breach may be predicated on the substance of a business decision, but only in extreme circumstances. The shareholders must establish that the decision has no rational business purpose[110] or amounts to a waste of

108. *See supra* note 20 and accompanying text.

109. *See* White v. Panic, 783 A.2d 543, 554 n.36 (Del. 2001) ("[T]he board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests."); *id.* at 553–55; *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005) ("The Delaware Supreme Court has implicitly held that committing waste is an act of bad faith."); *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 Del. Ch. LEXIS 9, at *41 n.13 (Del. Ch. Jan. 31, 1989) ("As I conceptualize the matter, such limited substantive review as the rule contemplates (*i.e.*, is the judgment under review 'egregious' or 'irrational' or 'so beyond reason,' etc.) really is a way of inferring bad faith."); Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 29 (2007) (suggesting that earlier cases had treated "bad faith as tantamount to fraud or an absence of 'rationality' or a decision 'so far beyond the bounds of reasonable judgment' that it established a 'bad faith' act or omission" (footnotes omitted)).

110. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose.").

corporate assets.[111] This is an extremely heavy burden that is rarely satisfied.

F. A WORD ON EXCULPATION

There is one important wrinkle that must be addressed at this point, if only briefly: director exculpation. The Delaware General Corporation Law authorizes a corporate charter to eliminate the personal liability of directors for monetary damages for breach of the fiduciary duty of care.[112] The history of such provisions is well known and need not be repeated here.[113] It is sufficient to note that many companies have adopted such provisions, effectively eliminating personal liability for breach of the duty of care. It is obvious that this type of provision would have a significant practical effect on litigation.

For purposes of this Article, two observations are in order. First, although such a provision may eliminate personal liability for breach of the duty of care, it does not eliminate the duty of care itself. Thus, injunctive relief is not precluded.[114] Second, the statutory provision is not, itself, part of the law of fiduciary duties. It merely authorizes individuals to contract around the duty of care if they choose. At least in Delaware, if shareholders do not consent, the duty of care remains unchanged and liability for damages may result.[115] Thus, while the director exculpation statute may have significant real-world consequences, it does not alter the first paradigm for enforcement of fiduciary duties. It merely limits the remedies

111. *See* 1 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 1.42 (1994) ("A transaction constitutes a 'waste of corporate assets' if it involves an expenditure of corporate funds or a disposition of corporate assets for which no consideration is received in exchange and for which there is no rational business purpose, or, if consideration is received in exchange, the consideration the corporation receives is so inadequate in value that no person of ordinary sound business judgment would deem it worth that which the corporation has paid.").

112. *See infra* text accompanying note 170 (quoting DEL. CODE ANN. tit. 8, § 102(b)(7) (2010)). For a list of similar statutes, see Cindy A. Schipani, *Integrating Corporate Law Principles with CERCLA Liability for Environmental Hazards*, 18 DEL. J. CORP. L. 1, 34 n.109 (1993).

113. *See, e.g.*, John L. Reed & Matt Neiderman, *"Good Faith" and the Ability of Directors to Assert § 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty*, 29 DEL. J. CORP. L. 111, 113–19 (2004); Strine et al., *supra* note 12, at 659–63.

114. *Disney*, 907 A.2d at 752.

115. Delaware's exculpation statute is an opt-in provision. In some states, it is an opt-out provision. *See, e.g.*, OHIO REV. CODE ANN. § 1701.59(D) (West 2010). In others, it is a mandatory provision. *See, e.g.*, IND. CODE § 23-1-35-1(e) (2010). In still others, instead of complete exculpation, liability is limited to a specified amount. *See, e.g.*, VA. CODE ANN. § 13.1-692.1 (2010).

that may be available in many cases.

III. ARGUING SEMANTICS

Two of the leading protagonists in the debate on the number of fiduciary duties in corporate law are Vice Chancellor Strine and Eisenberg. Long before the Delaware Supreme Court reversed course in *Stone*, Strine was authoring opinions arguing that the duty of good faith should be seen as subset of the duty of loyalty.[116] More recently, in an article coauthored with Lawrence A. Hammermesh, R. Franklin Balotti, and Jeffrey M. Gorris, the Vice Chancellor refined his earlier arguments and his case more fully.[117] Eisenberg disagrees. In an article that predates *Stone*, he argues that good faith is, and should be considered, a separate duty.[118]

Semantics play a surprisingly large role in their debate. In this part, I will consider the arguments raised by Strine, as well as some of Eisenberg's responses. Section A addresses the etymological arguments. I contend that Strine does not prove that the terms good faith and loyalty are synonymous. Section B considers an important test of whether good faith is a subset of loyalty: whether it is possible for one who acts in bad faith to be considered loyal. I argue that it is. Section C addresses the role of good faith in the Delaware General Corporation Law. I argue that the evidence supports the existence of a separate duty of good faith. Section D addresses the rest of Strine's arguments. I contend that Strine develops a framework for conceptualizing fiduciary duties that is plausible, but he does not present compelling evidence to support his theory. This is important because other theories are also plausible. Section E concludes that the number of fiduciary duties cannot be determined by reference to semantic arguments.

A. ETYMOLOGY

Strine's arguments begin with etymology. Essentially, he notes that

116. *See, e.g.*, Teachers' Ret. Sys. of La. v. Aidinoff, 900 A.2d 654, 668 (Del. Ch. 2006); Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 387 (Del. Ch. 2004); Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003); Nagy v. Bistricer, 770 A.2d 43, 49 n.2 (Del. Ch. 2000); *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 475–76 n.41 (Del. Ch. 2000) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 368 n.36 (Del. 1993)); *In re* ML/EQ Real Estate P'ship Litig., No. 15741, 1999 Del. Ch. LEXIS 238, at *16 n.20 (Del. Ch. Dec. 20, 1999).

117. *See* Strine et al., *supra* note 12. For the sake of convenience, I will refer to the coauthors collectively as "Strine."

118. *See* Eisenberg, *supra* note 12.

"loyalty, fidelity, and faithfulness are all synonyms,"[119] and that, "[p]ut together with the word 'good,' the word 'faith' bears an unbreakable relationship to concepts of fidelity and loyalty."[120] He concludes that "it is linguistic nonsense to divorce the defining concept of good faith from the terms—faith, fidelity, and loyalty—to which it gives effective life."[121]

Eisenberg takes issue with Strine's etymology. He argues that Strine "*looked up the wrong word*."[122] Specifically, Eisenberg contends that

> [t]here is a crucial difference between *faith*, upon whose definition the Vice Chancellor's argument rests, and *good faith*. Faith, as Vice Chancellor Strine accurately reports, means *allegiance*. Good faith does not. The difference is severe. . . . [T]he definition of good faith includes multiple elements, and . . . neither allegiance nor loyalty is one of those elements.[123]

Eisenberg then shows how dictionary definitions of the term good faith demonstrate that it is not synonymous with loyalty.[124]

Strine does not respond directly to Eisenberg's argument. He admits that "the phrase 'good faith' is often broadly defined as 'honesty or lawfulness of purpose' or 'compliance with standards of decency and honesty,'"[125] but he tries to massage those definitions into conformity with his claim. Thus, he argues that the "broad usage is fully consistent with the requirement that to be 'good,' one has to be true to a certain form of 'faith.'"[126] Such arguments have a ring of plausibility, but are not persuasive.

Strine does offer one strong etymological argument in response to Eisenberg. As he notes, "*The Oxford English Dictionary* defines good faith as 'fidelity, loyalty' and directs the reader to the following definition of faith: 'The quality of fulfilling one's trust; faithfulness, fidelity, loyalty.'"[127] This argument merits more attention.

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119. Strine et al., *supra* note 12, at 644–45 (footnotes omitted).

120. *Id.* at 646.

121. *Id.* at 648.

122. Eisenberg, *supra* note 12, at 15.

123. *Id.*

124. *See id.* at 16.

125. Strine et al., *supra* note 12, at 646 (footnotes omitted) (quoting WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 527 (9th ed. 1988); and THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 757 (4th ed. 2000)).

126. *Id.*

127. *Id.* at 646 n.47 (alteration omitted) (quoting 5 OXFORD ENGLISH DICTIONARY 679 (2d ed. 1989) [hereinafter OED]).

The Oxford English Dictionary does not define the term "good faith" independently; rather, the term is included under the main entry of the term "faith." The complete definition reads as follows:

> 11. *good faith*, *bad faith*: = L. *bona*, *mala fides*, in which the primary notion seems to have been the objective aspect of confidence well or ill bestowed. The Eng. uses closely follow those of L.
>
> a. *good faith*: fidelity, loyalty (= sense 10 [*i.e.*, "The quality of fulfilling one's trust; faithfulness, fidelity, loyalty."]); *esp*. honesty of intention in entering into engagements, sincerity in professions, *bona fides*.
>
> . . . .
>
> b. *bad faith*: faithlessness, treachery; intent to deceive. *Punic* (rarely *Carthaginian*) *faith* (= L. *fides Punica*): faithlessness.[128]

A few observations are in order. First, although the definition does include reference to faithfulness and loyalty, this is not surprising given the term's inclusion as a mere "sense" (or subentry) of faith. In other dictionaries, it appears as a separate term.[129] Second, even in this definition, there seems to be a strong connotative tilt toward honesty and sincerity. Third, the definition emphasizes the Latin origin, bona fides, which *The Oxford English Dictionary* itself defines simply as "[g]ood faith, freedom from intent to deceive."[130]

Moreover, other dictionaries are much less supportive of Strine's claim. As Eisenberg points out, *Webster's Third New International Dictionary*,[131] the *American Heritage Dictionary*,[132] and the *Random House Dictionary*[133] all have definitions that have very little to do with loyalty. Honesty, sincerity, decency, and lawfulness seem to be the core meaning.

Legal dictionaries are generally in accord.[134] Like *The Oxford English*

128. 5 OED, *supra* note 127, at 679.

129. *See infra* notes 131–35 and accompanying text.

130. 2 OED, *supra* note 127, at 379.

131. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 978 (3d ed. 1993) ("[*G*]*ood faith n* : a state of mind indicating honesty and lawfulness of purpose : belief in one's legal title or right : belief that one's conduct is not unconscionable or that known circumstances do not require further investigation : absence of fraud, deceit, collusion, or gross negligence—usu. used with *in* . . . .").

132. *See* AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 757 (4th ed. 2000) ("Compliance with standards of decency and honesty.").

133. *See* RANDOM HOUSE UNABRIDGED DICTIONARY 822 (2d ed. 1993) ("[*G*]*ood' faith'*, accordance with standards of honesty, trust, sincerity, etc. (usually prec. by *in*) . . . .").

134. *See, e.g.*, BALLENTINE'S LEGAL DICTIONARY AND THESAURUS 275 (1995) ("[*G*]*ood faith n.*

Dictionary, *Black's Law Dictionary* adds a slight wrinkle. It defines good faith as follows:

> [*G*]*ood faith*, *n*. A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.—Also termed *bona fides*. Cf. *bad faith*.[135]

For the most part, this definition tracks the others. However, the second numbered clause, "faithfulness to one's duty or obligation," seems consistent with Strine's position. Ironically, Eisenberg cites *Black's Law Dictionary*, while Strine does not.[136] This is not coincidental. Rather, it reflects the fact that, on balance, the definition supports the claim that good faith is something different from loyalty.

Thus, from a purely etymological perspective, Strine's argument is unpersuasive. Good faith is something different from loyalty. There may be some overlap, but not enough to suggest that good faith is a subset of loyalty.

B. LOYALTY WITHOUT GOOD FAITH?

One straightforward way to determine whether good faith is a subset of loyalty is to ask whether it is possible for someone to be loyal without acting in good faith. Both Strine and Eisenberg consider this by focusing on one specific aspect of the duty of good faith: the duty to avoid intentional violations of law. If a director who intentionally violates the law can be considered loyal to the corporation and its shareholders, then good faith cannot be considered merely a subset of loyalty.

Fairness and equity; the absence of improper motive or of a negligent disregard of the rights of others; the honest and reasonable belief that one's conduct is proper; the opposite of fraud and deceit."); 1 JOHN BOUVIER, LAW DICTIONARY 211 (14th ed. 1880) ("[*B*]*ona fides*. Good faith, honesty, as distinguished from *mala fides* (bad faith)."); 1 ALEXANDER M. BURRILL, LAW DICTIONARY 213 (2d ed. 1870) ("[*B*]*ona fides*. Lat. In the civil and common law. Good faith; honesty; sincerity. The opposite of *mala fides*, (q.v.)."); MERRIAM-WEBSTER'S DICTIONARY OF LAW 215 (1996) ("[*G*]*ood faith n* [*translation of Latin bona fides*] : honesty, fairness, and lawfulness of purpose: absence of any intent to defraud, act maliciously, or take unfair advantage." (second set of brackets in original)); LAW.COM LAW DICTIONARY, http://dictionary.law.com/Default.aspx?selected=819 (search "Enter a Legal Term" for "good faith"; then follow "good faith" hyperlink under "Select a word") ("[*G*]*ood faith* n. honest intent to act without taking an unfair advantage over another person or to fulfill a promise to act, even when some legal technicality is not fulfilled. The term is applied to all kinds of transactions.").

135. BLACK'S LAW DICTIONARY 762 (9th ed. 2009).

136. *See* Eisenberg, *supra* note 12, at 16; Strine et al., *supra* note 12.

According to Eisenberg:

> A manager's obligation not to knowingly cause the corporation to violate the law has traditionally and properly been founded on the duty of good faith. A corporate manager who knowingly causes the corporation to violate the law lacks honesty, because he knows that he is acting improperly and is violating generally accepted standards of decency applicable to the conduct of business. In addition, such a manager lacks fidelity to his office, because the organization in which his office is embedded is obliged to act within the boundaries set by the law and can reasonably expect its managers to act accordingly. In contrast, the obligation not to knowingly cause the corporation to violate the law cannot be founded on the duties of care and loyalty. A manager who knowingly causes the corporation to violate the law will seldom violate the duty of loyalty, because typically the manager does not engage in self-interested conduct, and will seldom violate the duty of care, because typically the manager rationally believes that the illegal conduct will serve the end of profit maximization.[137]

Strine disagrees. Because his definition of loyalty includes fidelity in every sense of the word, including general fidelity to office, a breach of good faith is necessarily a breach of loyalty:

> For a corporate director knowingly to cause the corporation to engage in unlawful acts or activities or enter an unlawful business is disloyal in the most fundamental of senses. A publicly chartered corporation becomes a legal citizen imbued with rights and responsibilities. When directors knowingly cause the corporation to do what it may not—engage in unlawful acts or unlawful businesses—they are disloyal to the corporation's essential nature. By causing the corporation to become a lawless rogue, they make the corporation untrue to itself and to the promise underlying its own societally authorized birth. No agent can act loyally toward a principal by undertaking, without authority, consciously unlawful activity in the name of the principal. In the case of a corporation, the corporation has no power to give directors that authority because the corporation's existence is premised on the nondefeasible promise that it will conduct only lawful business through lawful activities. Law compliance thus comes ahead of profit-seeking as a matter of the corporation's mission, and directors owe a duty of loyalty to that hierarchy. In so creating that hierarchy, corporation law has imbued all corporations with the mandatory value system of many sole proprietors, who would rather make less money than reap profits by engaging in illegal businesses or activities. Fidelity to that hierarchy is

137. *Id.* at 38 (footnote omitted).

> required of corporate directors in their supervision of the corporation's affairs.[138]

Who has the better argument? As a positive matter under *Stone*, the answer clearly is Strine. However, this debate presupposes that the *Stone* court may have gotten it wrong. Before *Stone*, it would not have been difficult to demonstrate that the standard of review for the duty of loyalty focused on financial conflicts.[139] The real question, then, is this: Setting aside *Stone*, what is the best characterization of the duty of loyalty?

Strine defends a very broad description of the duty of loyalty on the grounds that "it has been traditional for the duty of loyalty to be articulated *capaciously*, in a manner that emphasizes not only the obligation of a loyal fiduciary to refrain from advantaging herself at the expense of the corporation but, just as importantly, to act affirmatively to further the corporation's best interests."[140] There are a number of problems with this claim, however.

In the first place, it is not clear that when courts use such capacious language, they are always referring to the duty of loyalty specifically, as opposed to fiduciary duties generally. Take, for example, the classic language in *Guth*, which was quoted earlier.[141] This passage generally is considered to refer to the duty of loyalty. Because the facts of the case involved the duty of loyalty, this is a natural inference. Close examination, however, reveals that most of the passage actually deals with fiduciary duties generally, rather than the duty of loyalty specifically. It is noteworthy that Strine describes loyalty as including not only a negative component, but also an affirmative component. Linguistically, this phrasing reflects an attempt to expand the breadth of loyalty. By comparison, the *Guth* court describes a fiduciary's duty as including not only an affirmative component, but also a negative component. Only thereafter does the opinion mention loyalty; and when it does so, it focuses on conflicts of interest. Thus, for the entire passage to be interpreted as referring to the duty of loyalty, the *Guth* court would have had to consider loyalty as consisting primarily of affirmative duties and only secondarily of the avoidance of conflicts. This, however, seems doubtful.[142] The more

138. Strine et al., *supra* note 12, at 650–51 (footnotes omitted).

139. *See infra* notes 154–56 and accompanying text.

140. Strine et al., *supra* note 12, at 634 (emphasis added). *See also* Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 37–42 (2003).

141. *See supra* text accompanying note 30.

142. In *Unocal*, the Delaware Supreme Court's interpretation of *Guth* seems consistent with my

reasonable interpretation is that the *Guth* court was speaking of fiduciary duties generally before turning to the duty of loyalty in particular.[143] Thus, Strine's reliance on capacious language is unwarranted.[144]

Of course, there have been other cases in which courts have spoken specifically of the duty of loyalty in equally capacious terms.[145] This

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own: that the *Guth* court was speaking about more than just the duty of loyalty. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). Immediately after citing *Guth* for the "the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders," the opinion states that "their *duty of care* extends to protecting the corporation and its owners from perceived harm whether a threat originates from third parties or other shareholders." *Id*. (emphasis added) (citation omitted). This suggests that the court understood *Guth*'s affirmative duty to be referring to the duty of care rather than the duty of loyalty.

143. Admittedly, at the very end, the passage arguably seems to conflate honesty, good faith, and loyalty: "The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale." Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). Despite the appearance of conflation, however, the passage is perfectly consistent with the interpretation that I propose: the court is speaking of both fiduciary duties generally and loyalty in particular. The above-quoted passage could be paraphrased as follows: "The occasions for the determination of breach vel non of fiduciary duty are many and varied, and no hard and fast rule can be formulated. As a result, the standard of loyalty is measured by no fixed scale."

144. Strine also relies on Chancellor Allen's opinion in *In re RJR Nabisco, Inc. S'holders Litig.*, No. 10389, 1989 Del. Ch. LEXIS 9 (Del. Ch. Jan. 31, 1989). Strine quotes the following passage in particular:

> Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, or, as is here alleged, shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation. But if he were to be shown to have done so, how can the protection of the business judgment rule be available to him? In such a case, is it not apparent that such a director would be required to demonstrate that the corporation had not been injured and to remedy any injury that appears to have been occasioned by such transaction?

Id. at *46–47. As Strine admits, however, this passage appears in a discussion of good faith, not loyalty. Strine et al., *supra* note 12, at 676. Moreover, the preceding sentence makes clear that the passage is not about the duty of loyalty at all, but rather about the business judgment rule. *See Nabisco*, 1989 Del. Ch. LEXIS 9, at *46 ("Neither case, however, can be read to hold that the protections of the business judgment rule would be available to a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation's best interests."). Although it is true that "Chancellor Allen nowhere articulates a 'third' duty separate from loyalty or care," Strine et al., *supra* note 12, at 676, his opinion predated the Delaware Supreme Court's triadic formulation of fiduciary duties and the modern development of the concept of good faith, so that should not be expected. Nevertheless, it seems reasonably clear that Chancellor Allen understood that he was doing something different under the guise of good faith than was typical for the duty of loyalty.

145. Strine cites *Ivanhoe Partners v. Newmont Mining Corp*., 535 A.2d 1334, 1345 (Del. 1987) ("[The duty of loyalty] embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage."); and *In re The Walt Disney Co. Derivative Litig.*, No. 15452, 2004 Del. Ch. LEXIS 132, at *24 n.49 (Del. Ch. Sept. 10, 2004) ("[A]s this Court previously stated, the 'duty of loyalty . . . imposes an affirmative obligation to protect and advance the interests of the corporation and mandates that [a director] absolutely refrain from any conduct that would harm the

should not be surprising. Earlier courts were not dealing with the issues that are relevant today—issues of the precise number of fiduciary duties—and the question probably did not even occur to them. Moreover, as Strine notes, "the primary equitable duty that was thought to constrain directors until the issuance of the *Van Gorkom* decision in 1985 was the duty of loyalty."[146] With litigation focused on the duty of loyalty, it would not be surprising to find judicial opinions focusing on the duty of loyalty. That does not mean that there was not a separate duty of care, and possibly a separate duty of good faith.[147]

Finally, every fiduciary duty can be described in either broad or narrow terms. One manifestation of this is the divergence between standards of conduct and standards of review.[148] Just as the duty of loyalty can be described capaciously, so can the duties of care and good faith. Thus, there may be significant overlap among duties, in which case it would be unfair to characterize any one duty as a subset of another.[149]

The standard of conduct for a fiduciary duty often is significantly broader than the standard of review, but the two are closely related. They should be similar in scope, with the major difference being that the former demands more of directors than the latter. This is how it works with the duty of care. The standard of conduct requires ordinary care—the avoidance of negligence—while the standard of review requires more evidence of wrong-doing—gross negligence.[150] The subject matter of the two standards is identical. Effectively, I have argued earlier that this pattern

corporation.'" (quoting BelCom, Inc. v. Robb, No. 14663, 1998 Del. Ch. LEXIS 58, at *10 (Del. Ch. Apr. 28, 1998))). Strine et al., *supra* note 12, at 635 n.10. Both cases rely on *Guth*, however: *Ivanhoe* does so directly, *see Ivanhoe*, 535 A.2d at 1345 (citing *Guth*, 5 A.2d at 510); and *Disney* does so indirectly, through *BelCom, Inc. v. Robb*, 1998 Del. Ch. LEXIS 58, at *10 (citing *Guth*, 5 A.2d at 510), *see Disney*, 2004 Del Ch. LEXIS 132, at *24 n.49.

146. Strine et al., *supra* note 12, at 641 n.24.

147. Strine complains that the court "discovered" the duty of good faith in 1993, *see* Strine et al., *supra* note 12, at 639, but his concern is the categorization of good faith as a free-standing duty. He seems to agree with the substance of the duty, provided it remains a subset of loyalty. It is ironic that he is not concerned with the discovery of the substance of the duty of good faith as recently as 2005, *see In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005) (ascribing substantive meaning to duty of good faith), or what amounts to a substantive discovery of a duty of care in 1985, *see* Strine et al., *supra* note 12, at 641 n.24 ("Before [*Van Gorkom*], the duty of care had largely an admonitory, rather than enforceable, basis in American corporate law.").

148. *See generally* Eisenberg, *supra* note 20 (discussing how and why standards of review and of standards of conduct diverge in corporate law).

149. *See infra* Part IV.F.

150. *See supra* Part II.A.

is true of other fiduciary duties, as well.[151] The same should hold true for the duty of loyalty. Just as the standard of review focuses on conflicts of interest, so too should the standard of conduct be understood to focus on conflicts of interest.[152]

Strine decries the "rhetorical shrinking of the concept of loyalty" that would reduce the duty of loyalty to financial conflicts,[153] but the duty of loyalty is often described as relating primarily to financial conflicts.[154] Until *Stone*, it was broader in rhetoric only. In fact, only months before its *Stone* decision, in the *Disney* case, the Delaware Supreme Court said the following:

> [T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (*i.e.*, preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision. To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.[155]

Even if this passage can be said to be consistent with the later opinion in

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151. *See supra* Parts II.B–II.E.

152. The alternative is to expand the duty of loyalty to comprise two very divergent standards of review. This is possible but, as I argue in Part IV, it is simpler to say that they are two different fiduciary duties.

153. Strine et al., *supra* note 12, at 634. *See also*, *e.g.*, *id*. at 644 ("[T]he only function of a separate duty of good faith would be to fill the conceptual space created by the shrinking of the traditionally broad duty of loyalty required to accommodate the conversion of the long-standing definition of a loyal state of mind into a free-standing duty. The free-standing duty of good faith is thus a solution to the problem of its own invention.").

154. *See, e.g.*, 1 BLOCK, BARTON & RADIN, *supra* note 97, at 261–64; Bainbridge, Lopez & Oklan, *supra* note 12, at 585 ("The duty of loyalty traditionally focused on cases in which the defendant fiduciary received an improper financial benefit."); Eisenberg, *supra* note 12, at 5 ("The standard of conduct under the duty of loyalty essentially requires a manager to act fairly when he acts in his own pecuniary self-interest or in the pecuniary interest of an associate or a family member."); Hill & McDonnell, *supra* note 49, at 835 ("Courts recognize self-dealing in situations where a director, officer, or controlling shareholder has clearly identifiable, specific monetary interests at stake in a decision that puts her own self-interest at odds with the interests of the corporation."); Reed & Neiderman, *supra* note 113, at 121 (noting that "existence, or lack thereof, of an adverse financial interest" is traditional concept of loyalty).

155. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 66 (Del. 2006).

Stone, which is doubtful, it establishes, at the very least, that the "classic" or "traditional" understanding of disloyalty refers to conflicts of interest. Moreover, in *Stone*, the court described the claim "that the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest" as a "doctrinal consequence" of its novel interpretation of good faith.[156] If this is correct and the (traditional) duty of loyalty is primarily about the avoidance of conflicts then an intentional violation of law is not necessarily a breach of the duty of loyalty.

Because the issue ultimately is more semantic than legal in nature, a commonsense approach would be helpful. The question, phrased generally, is this: Can one be honest without being loyal and loyal without being honest? The fair answer seems to be yes. One can be honest without being loyal by disclosing the conflict,[157] and one can be loyal without being honest by acting paternalistically.[158]

Phrased more specifically, the question is this: Can a director who intentionally violates the law be considered loyal to the corporation and its shareholders? Some very prominent commentators who have considered the question seem to think so.[159] Strine argues not: he believes that by violating the law, a director is not being loyal to the corporation or to its shareholders, who have not authorized the illegal actions.[160] This is a highly legalistic answer, and one that is not satisfying on a gut level.[161]

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156. Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

157. *Cf.* United States v. O'Hagan, 521 U.S. 642, 655 (1997) ("Because the deception essential to the misappropriation theory [of insider trading] involves feigning fidelity to the source of information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation—although the fiduciary-turned-trader may remain liable under state law for breach of a duty of loyalty.").

158. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 662 (Del. Ch. 1988).

159. *See, e.g.*, Bainbridge, Lopez & Oklan, *supra* note 12, at 591–94; Eisenberg, *supra* note 12, at 38.

160. *See* Strine et al., *supra* note 12, at 648–53.

161. Strine argues that "[t]o somehow contend that it is loyal to engage in consciously unlawful conduct because the directors believed in good faith that the conduct would be in the best interests of stockholders desiring profits but in bad faith toward society is, well, silly." *Id.* at 653. With all due respect, this argument is frivolous. No one argues that intentional violations of law should be permitted, or even that they should not constitute a breach of fiduciary duty. The only question is whether the duty breached is that of loyalty. Strine's argument boils down to a claim that the duty of loyalty is so expansive that it can easily encompass intentional violations of law. Eisenberg's claim, on the other hand—or at least mine—is that it is not a natural or obvious fit. Why try to fit the square peg of good faith into the round hole of loyalty? And while Strine is confident that even "elementary school students can grasp" his framework, *id.*, it is just as likely that even elementary school students would not be lost by a move from a framework that had two duties to one that had three, or even five. None of these frameworks are especially confusing. The question is which one works best.

Of course the courts cannot allow intentional violations of law. That does not mean that no one will ever want to violate the law, however. Realistically, the corporation and its shareholders may sometimes want the corporation to undertake illegal actions for pecuniary benefit even though the law forbids it.[162] Shareholders may communicate their desire for such an undertaking to the fiduciaries, either implicitly or explicitly.[163] If this occurs and the directors comply, it is theoretically possible for directors to violate the law intentionally without being disloyal to the corporation and its shareholders. Any "disloyalty" would be to the law and to society, which is not what the duty of loyalty is about.[164] Of course, it may be difficult to determine when intentional violations of law would be loyal and when they would be disloyal. This problem very well may warrant a prophylactic rule forbidding intentional violations of law. Such a rule, however, would be based on practical considerations rather than on loyalty itself.

Finally, it is unfair to say that any violation of the law, however small and regardless of the circumstances, would amount to a breach of the duty of loyalty. Difficult situations may require managers to prioritize among conflicting duties. In such cases, a director may reasonably conclude that it would be in the interests of the corporation and its shareholders to violate a very minor law in order to achieve a significant benefit—for example, double-parking in order to make an important delivery.[165] Such a decision may be wrong and illegal, but it would not necessarily be disloyal.

To be perfectly clear, I am not arguing that an intentional violation of law is ever acceptable or that it is not necessarily a breach of fiduciary duty. I am only arguing that it is not necessarily disloyal. If there is a breach of fiduciary duty, it is of the duty of good faith. Intentional violations of the law may be disloyal in many cases—perhaps even most cases—but they are not intrinsically so.

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162. As Strine points out, the law only permits corporate charters to authorize "lawful act[s] or activit[ies]." *See* Strine et al., *supra* note 12, at 650 (quoting DEL. CODE ANN. tit. 8, § 102(a)(3) (2010)).

163. I say "undertake" rather than "authorize" because the law need not treat an illegal undertaking as an authorized action.

164. Even the duty of good faith, which includes the prohibition against intentional violations of law, is not about a duty to the law or society. It is about honesty and uprightness toward the shareholders. The law merely presumes that shareholders want directors to obey the law, and that therefore intentional misconduct includes intentional violations of law.

165. *See* Bainbridge, Lopez & Oklan, *supra* note 12, at 592.

C. DELAWARE GENERAL CORPORATION LAW

Another line of argument in the debate between Strine and Eisenberg focuses on the use of the term good faith in the Delaware General Corporation Law. Eisenberg argues that "[t]here is little doubt that as a matter of positive law, corporate managers owe a duty of good faith."[166] He refers to section 145, which conditions director indemnification on good faith; section 144, which allows transactions tainted by a conflict of interest to be cleansed by the approval of disinterested directors provided that they act in good faith; and section 102(b)(7), which does not allow directors to be exculpated for liability for acts or omissions not in good faith.[167]

Strine discusses the various statutory provisions as well. He insists that the use of the term is consistent with his understanding of good faith as pertaining to the state of mind of a loyal fiduciary.[168] At least with respect to sections 144 and 145, however, there is more assertion than argument. Strine can be summarized as follows: "To us, it is obvious that th[ese] requirement[s] reflect[] a statutory adoption of the core concept of loyalty, which is that directors must act in the good faith belief that their decision will benefit the corporation and its stockholders ratably and not for an improper purpose."[169] This does not refute Eisenberg's arguments.

Strine's best arguments are raised in the discussion of section 102(b)(7). That provision reads as follows:

> [T]he certificate of incorporation may . . . contain . . . the following . . . :
>
> . . . .
>
> 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, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.[170]

Strine admits that the separate references to loyalty and good faith

166. Eisenberg, *supra* note 12, at 6.
167. *Id.* at 6–10 (citing DEL. CODE ANN. tit. 8, §§ 102(b)(7), 144–145 (2010)).
168. Strine et al., *supra* note 12, at 655–59.
169. *Id.* at 657.
170. DEL. CODE ANN. tit. 8, § 102(b)(7).

may suggest that the two are separate duties.[171] He argues, however, that this is merely "redundancy" which "operat[es] as a belt-and-suspenders protection against unintended consequences."[172]

Strine suggests that the provision could have been written, and should be interpreted, as follows:

> The certificate of incorporation may include a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damage for breach of fiduciary duty of care as a director, provided that such provisions shall not eliminate or limit the liability of a director for a breach of the duty of loyalty, including but not limited to any:
>
> i) transactions from which the director derived an unfair or improper personal profit or benefit;
>
> ii) acts or omissions not in good faith;
>
> iii) intentional misconduct; or
>
> iv) knowing violations of law.
>
> In addition, the certificate may not limit a director's liability for a violation of § 174 of this chapter.[173]

In fact, this interpretation reflects significant revision. Strine does not have a very good explanation for why the drafters did not mean what they said or say what they meant. His only explanation for the inclusion of the duty of good faith was that the plaintiffs' bar insisted on it.[174] Far from proving his point, however, this actually establishes that practicing attorneys believed that good faith was something different from loyalty. Because this demand prevailed, it seems odd to suggest that the secret intentions of the drafters should govern.

If, as Strine argues, the drafters wanted to distinguish between the duty of care, which is exculpable, and the duty of loyalty, which is not,[175] they could have rewritten the statute as easily as Strine did. There is an even easier solution, however: the provision could have stated simply that only breaches of the duty of care may be exculpable, without mentioning

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171. Strine et al., *supra* note 12, at 659 ("We do not pretend that section 102(b)(7) does not suggest that there is a category of bad faith acts that cause corporate injury that is somehow beyond the reach of the duty of loyalty. The separate references to the duty of loyalty and to acts 'not in good faith' can be thought to have exactly that implication.").

172. *Id.* at 660.

173. *Id.* at 662–63.

174. *Id.* at 662.

175. *Id.* at 660–62.

the duty of loyalty or anything else. The solution is so obvious that I often have wondered why they did not settle on it.[176] In any event, regardless of what the drafters could have done or should have done, the law reflects only what they did in fact.

Strine raises a similar counterargument. He notes that there is no "indication that the statute was intended to recognize new fiduciary duties,"[177] and that the statute refers to loyalty as a "duty," but to good faith only as the quality of an act or omission, and not as a "duty."[178] Thus, his argument runs, the statute should not be interpreted as creating a new duty. This is a fair point, but no one has argued that the statute should be interpreted in that way. The concept of good faith significantly predates section 102(b)(7). Those who claim that good faith is an independent duty insist that it has always existed, if only implicitly.[179]

Strine also argues that the reliance on section 102(b)(7) to prove the existence of a duty of good faith is problematic:

> [I]f the separate articulation in section 102(b)(7) from the duty of loyalty of "acts not in good faith" as a category of nonexculpable conduct supports a more general fiduciary duty of "good faith," section 102(b)(7) becomes a source of several new fiduciary duties. Along with the duty to act in good faith, there would emerge no fewer than four other duties: (1) the duty not to engage in intentional misconduct; (2) the duty not to knowingly violate the law; (3) the duty not to pay dividends in violation of section 174; and (4) the duty not to receive improper personal benefits.[180]

Unfortunately, Strine's argument is too simplistic. He overlooks the fact that the duty of loyalty is dealt with in clause (i), while bad faith,

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176. I have always believed it was because the drafters had a notion that there might be additional duties or that the courts might shuffle the content of the various duties. Because the law of fiduciary duties is always developing, this is a reasonable fear. Thus, drafters who tilted promanagement would not want to limit exculpation to the duty of care; they would want to exculpate everything except a few specified items. Drafters representing the plaintiffs' bar, on the other hand, would "want[] very broad exceptions." *Id.* at 662.

177. *Id.* at 661.

178. *Id.* at 662.

179. *See* Eisenberg, *supra* note 12, at 11 ("In short, the duty of good faith has long been both explicit and implicit in corporation statutes and implicit in case law. Recently, it has become explicit in case law as well.").

180. Strine et al., *supra* note 12, at 660. He goes on to point out that "just as section 102(b)(7) separates the duty of loyalty from 'intentional misconduct' and the receipt of 'improper personal benefits,' so too does section 102(b)(7) separate its references to 'acts not in good faith' from 'knowing violations of law.'" *Id.*

intentional misconduct, and knowing violation of law are dealt with together in clause (ii). Thus, it is reasonable to interpret the three categories in the second clause as roughly synonymous with each other but different from clause (i). Clause (iii) deals with improper dividends. This has nothing to do with disloyalty; section 174 exists for the protection of creditors.[181]

Clause (iv) is a bit more tricky. Strine argues that

> even those inclined to view the obligation of loyalty as an extremely narrow one, consisting only of the negative obligation not to profit at the expense of the corporation, must admit the difficulty of distinguishing between a breach of the duty of loyalty and a breach of the duty not to receive an "improper personal benefit."[182]

At first glance, this seems like a good point. Clause (iv), however, does not create a "duty not to receive an improper personal benefit"; it merely provides that directors cannot be exculpated for transactions that result in improper personal benefits. It is not difficult to imagine that a director who has not been found to have violated the duty of loyalty—because they are not conflicted (ex ante)—nevertheless could receive an improper personal benefit (ex post). Thus, clause (iv) presents no difficulty. Its scope exceeds that of the duty of loyalty. In short, it seems entirely fair to read section 102(b)(7) as permitting director exculpations except in cases of (i) breach of the duty of loyalty, (ii) breach of the duty of good faith, (iii) improper dividends, and (iv) other improper personal benefits.

Thus, the Delaware General Corporation Law provides support for the existence of an independent duty of good faith. Although it does not explicitly create the duty of good faith, neither does it explicitly create a duty of care or loyalty. In each case, it assumes the existence of fiduciary duties that, after all, are equitable rather than legal concepts.

181. *See* DEL. CODE ANN. tit. 8, § 174 (2010).

182. Strine et al., *supra* note 12, at 660. Along the same lines, Strine elsewhere "[r]eadily [m]ake[s]" "[o]ne [l]inguistic [c]oncession": that "judges in particular have referred in the same sentence or paragraph to both the words 'loyalty' and 'good faith,' leading to the argument that they must be wholly distinct concepts and that one cannot be subsumed within the other." *Id.* at 653. He claims, however, that this is mere "redundanc[y]" used "for emphasis and rhetorical flourish." *Id.* He argues that this cannot be the basis for separating what is essentially the same concept, or else there might be an infinite number of fiduciary duties. *Id.* at 653–55. Of course, whether good faith and loyalty are essentially the same concept is the issue at hand. This argument, however, is best dealt with in a subsequent section. *See infra* Part IV.B.

D. PLAUSIBILITY OF STRINE'S THESIS

Strine spends significant effort attempting to demonstrate that legal usage of the terms good faith and loyalty are consistent with his theory. Ultimately, Strine succeeds in creating a framework for the conceptualization of fiduciary duties that is plausible, but by no means compelling or definitive. The problem for Strine is that Eisenberg's framework, consistent with the triadic formulation of fiduciary duties, is also reasonable.

Close examination reveals that Strine's persuasiveness stems primarily from the fact that he tells the reader what to look for before examining the evidence. This approach is perfectly valid in that it makes it easier to follow the argument. To a great extent, however, Strine's argument depends on presenting the lens through which the reader can view the evidence. Although Strine repeatedly asserts that his interpretations are "clear,"[183] independent review of the evidence (without Strine's gloss) would not necessarily lead the reader to the same conclusions.

For example, Strine argues that "the term good faith has long been used as the key element in defining the state of mind that must motivate a loyal fiduciary."[184] It is understandable that he might think so. After all, the primary components of good faith—honesty and sincerity—are states of mind. Good faith, however, is not necessarily so limited.[185] It certainly does not follow that good faith is merely a subset of the duty of loyalty. That step requires a leap in logic that is facilitated by the lens that Strine provides at the outset. Without this lens, Strine's work is merely an argument in support of an alternative way of thinking about good faith.

The lens that Strine provides is a broad interpretation of the duty of loyalty—as the duty to serve the legitimate interests of the corporation—and a correspondingly narrow interpretation of the duty of good faith—as the subjective component of loyalty. One just as easily could argue, however, that loyalty is an objective component of good faith,[186] or that the two are simply different. In fact, much of the evidence supplied by Strine

183. The terms "clear" and "clearly" are used throughout Strine's article. *See* Strine et al., *supra* note 12.

184. *Id.* at 633.

185. For example, Eisenberg argues that good faith has a strong objective component. Eisenberg, *supra* note 12, at 23. *See also* 5 OED, *supra* note 127, at 679 (stating that "the primary notion [of good faith] seems to have been the objective aspect of confidence well or ill bestowed").

186. *See infra* text accompanying note 243.

highlights the importance of good faith in the law of fiduciary duties and actually supports the claim that the duty of good faith is not subordinate to loyalty, but equal or even superior to it.

To illustrate the point, I will reproduce many of the passages that Strine quotes in support of his proposition, but without his contextualizations. Notice that in none of the passages is good faith represented as subordinate to or part of loyalty. To the contrary, loyalty is not even mentioned in the majority of the following passages.

Consider first the passages quoted by Strine in his discussion of agency law:

- "The paramount and vital principle of all agencies is good faith, for without it the relation of principal and agent could not well exist."[187]
- "The relation existing between a principal and his agent is a fiduciary one, and consequently the most absolute good faith is essential. The principal relies upon the fidelity and integrity of the agent, and it is the duty of the agent, in return, to be loyal to the trust imposed in him, and to execute it with the single purpose of advancing his principal's interests."[188]
- "It is the duty of the agent to exercise good faith and loyalty toward the principal in the transaction of the business entrusted to him."[189]

From all of this, Strine concludes that "it is the agent's general duty to act loyally—that is, in the interests of the principal—that gives rise to the more specific duty to avoid taking positions in which the agent's interests are in conflict with those of the principal."[190] However, this conclusion depends on the assumption that acting "in the interests of the principal" is the demand of loyalty alone rather than of fiduciary duties generally, or of each fiduciary duty in a particular way.[191] On their own, the passages seem to emphasize the importance of good faith rather than loyalty.

Consider next the passages quoted by Strine in his discussion of trust law:

187. Strine et al., *supra* note 12, at 666 n.107 (quoting THE AMERICAN AND ENGLISH ENCYCLOPEDIA OF LAW 1071 (David S. Garland & Lucius P. McGehee eds., 2d ed. 1896)).

188. *Id.* (quoting ERNEST W. HUFFCUT, THE LAW OF AGENCY § 90 (2d ed. 1901)).

189. *Id.* (quoting FRANCES B. TIFFANY, HANDBOOK ON THE LAW OF PRINCIPAL AND AGENT § 146 (Richard R.B. Powell ed., 2d ed. 1924)).

190. *Id.*

191. *See infra* text accompanying note 313.

- "There are circumstances . . . [the trustee's financial self-interest] which raise a presumption of bad faith on the part of the trustee."[192]
- "Trustee Should Exercise Good Faith and Due Diligence in Protection of Estate."[193]
- "Absolute and most scrupulous good faith is the very essence of the trustee's obligation. The first and principal duty arising from this fiduciary relation is to act in all matters of the trust wholly for the benefit of the beneficiary."[194]

Again, this evidence leads Strine to conclude that "the bond between loyalty and good faith is inseparable."[195] Standing alone, however, these passages suggest that it is good faith, rather than loyalty, that demands that the fiduciary act in the interests of the beneficiary.

Consider the passages quoted by Strine when he turns to corporations:

- "The underlying principles have not changed during the years. Directors are held to two fundamental tests: (a) honesty and good faith; [and] (b) diligence."[196]
- "[I]t is an implied condition that [the director's] discretion shall be used in good faith for the benefit of the principal, and in accordance with the true purpose of the agent's appointment . . . . It is manifest, therefore, that the directors of a corporation occupy a position of the highest trust and confidence, and that the utmost good faith is required in the exercise of the powers conferred upon them."[197]
- "[D]irectors 'must exercise the utmost good faith in all transactions touching their duties to the corporation and its property' and . . . [a]ll their acts must be for the benefit of the corporation,

192. Strine et al., *supra* note 12, at 667 (alteration in original) (quoting Wormley v. Wormley, 21 U.S. (8 Wheat.) 421, 438 (1823)).

193. *Id.* (quoting 3 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN AMERICA § 1676 (14th ed. 1918)).

194. *Id.* at 667–68 (quoting 4 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1075 (5th ed. 1941)).

195. *Id.* at 668.

196. *Id.* at 668 n.125 (alteration in original) (quoting 1 GEORGE D. HORNSTEIN, CORPORATION LAW AND PRACTICE § 431 (1959) (citation omitted)).

197. *Id.* at 668–69 (ellipsis in original) (quoting 1 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 516 (2d ed. 1886)).

and not for their own benefit."[198]

- "Directors . . . of a corporation are liable to it for any loss which it may sustain by reason of their refusal or failure to enter into a contract for its benefit, if they do not act in good faith."[199]

Strine even quotes S. Samuel Arsht:

- "A director may also lose the benefit of the business judgment rule if plaintiff proves that the director's challenged decision was prompted by improper motive, that the director was not truly independent from an interested party, or any other circumstance demonstrating a lack of good faith."[200]

Again, Strine concludes that these passages demonstrate "the equivalence of loyalty and good faith."[201] A more straightforward reading of these passages, however, suggests that good faith is a, and perhaps *the*, paramount duty and that the avoidance of conflicts is a subset of that duty.

The case law that Strine quotes in the same section carries a similar import[202]:

- "[A director or officer] stands in a fiduciary relation which requires him to exercise the utmost good faith in managing the business affairs of the company with a view to promote, not his own interests, but the common interests, and he cannot directly or indirectly derive any personal benefit or advantage by reason of his position distinct from the coshareholders."[203]

- "A complete absence of selfish motive and of personal profit on their part forcefully argues that [the directors'] judgment was formed in absolute honesty and entire good faith."[204]

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198. *Id.* at 669 (second alteration in original) (quoting 2 SEYMOUR D. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS § 1215, at 164 (2d ed. 1909)).

199. *Id.* at 669 n.127 (quoting WILLIAM L. CLARK & WILLIAM L. MARSHALL, MARSHALL ON PRIVATE CORPORATIONS 1010 (1902)).

200. *Id.* at 672 (alteration omitted) (quoting S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 127 (1979)). That Arsht does not see good faith and loyalty as the same concept is evident from the fact that he deals with them separately, in different sections. *See* Arsht, *supra*, at 115–18, 127–30.

201. *Id.* at 668.

202. I omit *Guth* because the case has already been discussed. *See supra* notes 30, 141–44 and accompanying text.

203. Strine et al., *supra* note 12, at 669 (alteration in original) (quoting Cahall v. Lofland, 114 A. 224, 228 (Del. Ch. 1921)).

204. *Id.* at 667 (alteration in original) (quoting Bodell v. Gen. Gas & Elec. Corp., 132 A. 442, 449 (Del. Ch. 1926)).

Once again, these passages highlight the prominence of good faith, not loyalty.

Strine's discussion of takeover cases—*Cheff v. Mathes*,[205] *Unocal*,[206] and *Revlon*[207]—is similar.[208] He shows that courts demand that directors act in good faith in the best interests of the corporation, but not that good faith is part of the duty of loyalty.[209]

I am not arguing that good faith is superior to loyalty. I believe that they are equal in stature. My point is only that Strine's evidence does not support his claim that loyalty is superior to, and encompasses, good faith. At most, Strine only shows that loyalty, fidelity, faithfulness, and good faith are related terms.[210] While this is self-evident, it entails many different possible explanations and ramifications.[211]

E. CONCLUSION ON SEMANTICS

Ultimately, the issue of the relation between good faith and loyalty is not one that can or should be resolved by etymology, linguistics, or other semantic arguments. This is because good faith is a legal term that must be given meaning by way of artificial construction. To some extent the legal term will track common usage, but to some extent it will not. Moreover, courts sometimes use the term in a legalistic sense and sometimes use it in the more common sense; sometimes, they will switch between the two senses in the same discussion. What is needed is a framework that is not merely plausible, but one that is also elucidating. And that will not be found by reference to intuitiveness. Common usage gives us a starting

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205. Cheff v. Mathes, 199 A.2d 548 (Del. 1964).

206. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

207. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

208. Strine et al., *supra* note 12, at 670–72.

209. Strine claims that the following passage from *Revlon* "explicitly demonstrates the use of good faith to define the core mandate of loyalty, which is to act solely in the interest of the corporation and its stockholders," *id.* at 672: "[O]btaining the highest price for the benefit of the stockholders should have been the central theme guiding director action. Thus, the Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders," *Revlon*, 506 A.2d at 182. In fact, this passage is perfectly consistent with the notion that good faith is superior to loyalty. It says that directors could not show good faith because they ignored loyalty; it does not say they could not show loyalty because they were not acting in good faith.

210. Lyman Johnson shows that care is closely related as well. *See infra* notes 231–39 and accompanying text.

211. As will be discussed more fully in the next part, good faith, loyalty, and care (as well as objectivity and rationality) are all aspects of one core fiduciary duty: to pursue the interests of the corporation and its shareholders.

point, but the legal definition must ultimately be based on functional considerations as well.

IV. HOW TO THINK ABOUT FIDUCIARY DUTIES

In Part III, I argued that the current debate has improperly concentrated on semantic arguments. What is needed is a framework that will provide a solid and stable foundation for courts and practitioners. In this part, I hope to provide such a framework.

In a 2007 essay, Hill and McDonnell argue that fiduciary duties can be understood at varying levels of abstraction.[212] This crucial insight helps explain the relationship among the various fiduciary duties. Most importantly, it highlights the fact that the answer to the question of how many fiduciary duties there are in corporate law can be virtually any number, depending on the level of abstraction considered. Thus, there is no single correct answer. Any answer may be correct in some respects, but none is accurate in every respect. In this part, I argue that, if the question must be asked, the best answer is five: distinguishing among fiduciary duties based on the paradigms for enforcement is most likely to lead to meaningful distinctions without risk of confusion.

In Section A, I explain the concept of levels of abstraction. In Section B, I explain how, at the highest level of abstraction, there is only one fiduciary duty. I argue that this fundamental duty is different from any of the particular fiduciary duties and comprises all of them. In Section C, I demonstrate that it is possible to move with increasing specificity to almost any number of fiduciary duties. In Section D, I argue that the most helpful level of abstraction is what I call the third level. This level distinguishes among the paradigms for enforcement of fiduciary duties. In Section E, I argue that simplifying the law so that there are two fiduciary duties can lead to oversimplification, and doing so risks collapsing the five paradigms for enforcement into two, resulting in a loss of precision and nuance. In Section F, I argue that the inherent complexity of the law of fiduciary duties makes it difficult to organize them along a single linear continuum, and that a better way of conceptualizing fiduciary duties is as a Venn diagram. Such an image highlights the fact that fiduciary duties are not entirely independent of each other but have significant overlap. In Section G, I explain the nature of the overlap. I argue that the determination of which fiduciary duty is involved in a case corresponds not to director

212. Hill & McDonnell, *supra* note 13, at 1788–91.

conduct, as is commonly believed, but rather to the shareholders' concerns about the conduct. Thus, a director's actions may implicate any or all of the fiduciary duties, depending on the circumstances and the available evidence. I conclude in Section H with a summary.

A. LEVELS OF ABSTRACTION

Hill and McDonnell have described fiduciary duties as follows:

> Director duties, and breaches thereof, fall along a continuum. There are stylized cases at both ends, where the procedures have been well developed. Care, with its very strong deference, which essentially translates into "plaintiff loses" (and even if he did not lose, there would be exculpation), is at one extreme. Traditional loyalty, where the defendant has to show good process (in the form of approval by disinterested and fully informed directors, shareholders, or both) or, failing that, very good substance (that is, "entire" or "intrinsic" fairness), is at the other extreme. Of most interest here are the cases that fall between these extremes, where we think good faith will increasingly become part of the doctrinal story.
>
> In dividing up the cases along this continuum, we can think at varying levels of abstraction . . . . At the very highest level, there is just one fiduciary duty—to pursue faithfully and diligently the best interests of the corporation and its shareholders. Below this level of abstraction, we can see the continuum of cases as divided into the two traditional categories, care and loyalty. Why divide the cases this way? As we discuss above and below, we put into the care category circumstances where we want courts to largely avoid scrutinizing board behavior, such that it is extremely unlikely that directors will ever be held personally liable. Loyalty cases deserve at least a bit of (and sometimes quite a bit of) a closer look from courts.
>
> One level of abstraction below that, we divide the loyalty category into two parts. One part, at the extreme end, is traditional loyalty cases, where directors or officers have a pecuniary material interest that conflicts with the interests of the corporation. The other part is good faith. This includes the intermediate cases that fall between traditional care and traditional loyalty. Why is this division of the broad loyalty category useful? Cases presenting facts that fall in the traditional loyalty category clearly deserve close scrutiny from some sort of independent decision maker, be it independent directors, shareholders, or the courts. We have well-established rules for these sorts of cases. Good faith is a more nebulous category. It includes many different kinds of factual circumstances, united by the fact that we have some reason to be concerned about director objectivity (hence, they are not care cases), but

> the stark concerns of traditional conflicts of interest are not present (hence, they are not traditional loyalty cases). It is thus useful to distinguish good faith from traditional loyalty.
>
> If we then descend one more level of abstraction, we find that the good faith region in turn subdivides at present into a variety of different factual circumstances and related standards of review. The more specific standards of review give structured guidance to courts, corporations, and their counselors where the facts fall within the scope of those specific standards. The general backdrop of good faith gives courts flexibility to deal with new circumstances that do not fit within better defined standards of review, and to develop new specific standards for other sorts of cases where appropriate.[213]

The insight that fiduciary duties can be understood at varying levels of abstraction is a crucial one. It can help explain and reconcile judicial opinions and scholarly theories that appear incompatible. It also provides a robust intellectual framework within which both judges and scholars can work. The increased intellectual latitude allows for the discovery of new insights regarding fiduciary duties while leading to the realization that no single perspective has an exclusive lock on the truth. Many different theories may be true to a point, but ultimately are inadequate in some respects. What rings true at one level of abstraction may seem wrong at another level.

Unfortunately, Hill and McDonnell develop their theory improperly. Three related errors prove fatal. First, they position the duty of good faith within the duty of loyalty.[214] This is to be expected because their essay is an attempt to deal with the recent case of *Stone*. Second, they position good faith in between care and loyalty as a sort of intermediate fiduciary duty.[215] As I will demonstrate, however, good faith does not lie between care and loyalty, but rather at the extreme. Third, they describe fiduciary duties as falling along a linear continuum.[216] As I will argue in the following sections, this provides an inadequate understanding of fiduciary duties, which are significantly more complex.

The claim that good faith lies between care and loyalty dates back to an earlier article in which Hill and McDonnell tackle structural bias.[217]

213. *Id.* at 1788–89 (footnotes omitted).
214. *See id.* at 1789.
215. *See id.* at 1791.
216. *See id.* at 1788.
217. *See* Hill & McDonnell, *supra* note 49.

Their thesis is understandable. There is significant intermediate ground between care and loyalty and, as I have argued in earlier work, it has to do primarily with structural bias.[218] Moreover, the duty of good faith is an emerging area of law that is somewhat "nebulous"[219] because it has not yet been defined very well. Thus, it is not surprising that Hill and McDonnell would turn to good faith to deal with structural bias. The intermediate ground that they identify, however, is not good faith.

Good faith is about intentional misconduct.[220] Structural bias is not. Structural bias is about subtle influences that affect the decisionmaking process, often unconsciously.[221] These influences are essentially conflicts of interest that do not rise to the level of self-dealing. Even in cases involving self-dealing, there need not be any actual misconduct—that is why the law gives directors the opportunity to prove fairness.[222] Because these influences undermine confidence in the decisionmaking process, however, tainted decisions are subjected to heightened review.[223]

Moreover, the standards of review that are employed in cases of structural bias and those involving good faith are entirely dissimilar. Structural bias invokes the third paradigm for the enforcement of fiduciary duties. Such cases are subjected to an intermediate standard of review—reasonableness—which lies somewhere between the leniency given to care cases and the strictness accorded to loyalty cases.[224] Good faith, on the other hand, invokes the fourth paradigm. In such cases, the shareholders bear the heavy burden of establishing intentional misconduct.[225] This is significantly more onerous than reasonableness, or even gross negligence.[226]

In short, Hill and McDonnell are wrong to identify the duty of good faith with the intermediate standards of review and structural bias. In doing so, they conflate the third and fourth paradigms for the enforcement of

218. *See* Velasco, *supra* note 19.

219. *See* Hill & McDonnell, *supra* note 13, at 1789 (describing good faith as "a more nebulous category").

220. *See supra* notes 78–86 and accompanying text.

221. *See* Velasco, *supra* note 19, at 853–65.

222. *See supra* notes 45–47 and accompanying text.

223. *See* Velasco, *supra* note 19, at 874.

224. *See supra* Part II.C.

225. *See supra* Part II.D.

226. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 65 (Del. 2006) ("[G]rossly negligent conduct, without more, does not and cannot constitute a breach of the fiduciary duty to act in good faith.").

fiduciary duties, which are actually very different from each other. I will explore the levels of abstraction with these differences in mind.

B. ONE FUNDAMENTAL FIDUCIARY DUTY

As to their first step, Hill and McDonnell are clearly correct: "At the very highest level, there is just one fiduciary duty—to pursue . . . the best interests of the corporation and its shareholders."[227] This should not be controversial: Strine agrees,[228] and I can think of no reason why Eisenberg would not. Nevertheless, the exact nature of this one fundamental fiduciary duty is controversial.

According to both Strine and Hill and McDonnell, the one fundamental fiduciary duty is, essentially, the duty of loyalty.[229] They view the duty of loyalty as a broad mandate to pursue the interests of the corporation, and everything else as falling within its expansive scope. There is one important, if technical, problem with this view: if every breach of fiduciary duty were a breach of the duty of loyalty, then no breach of fiduciary duty would be exculpable under section 102(b)(7).[230] Setting aside that issue, however, the claim seems plausible on its face. Yet other theories also are reasonable.

In an article about the duty of care, Lyman Johnson sets forth the foundation for a claim that the one fundamental fiduciary duty is the duty of care.[231] He argues that "[f]ar from being a simple concept, care is multidimensional," with "[a]t least three meanings."[232] First, directors are required to "'take care of' the corporation's business and affairs."[233] Second, a board must "'care for' the interests of the corporate enterprise and its shareholders, . . . not the directors' interests or those of any other

227. Hill & McDonnell, *supra* note 13, at 1788.

228. *See* Strine et al., *supra* note 12, at 635 ("[I]t is possible to conceive of there being only one core duty . . . .").

229. *See id.* at 635 ("We are willing to go further and to say that it is possible to conceive of there being only one core duty, that of loyalty, and that the duty of care is itself simply a component of what is expected of a faithful—that is, loyal—fiduciary."); Hill & McDonnell, *supra* note 13, at 1779 (citing Hill & McDonnell, *supra* note 49, at 855) ("[W]e think the duty of care was always fundamentally a duty of loyalty.").

230. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2010); *supra* text accompanying note 170 (quoting DEL. CODE ANN. tit. 8, § 102(b)(7)).

231. *See* Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787, 808–09 (1999). Johnson does not himself argue that care is the one core duty. His argument, however, provides support for such a claim.

232. *Id.* at 808.

233. *Id.*

party."[234] Third, "directors are to act 'carefully' or in a careful manner."[235] Such a broad understanding of the duty of care subsumes the other fiduciary duties. In Johnson's words, the second meaning, "care as solicitude *for* the interests of the enterprise and shareholders[,] is the foundation of the notions of loyalty and good faith."[236]

Aronson v. Lewis[237] lends some support to Johnson's argument.[238] Its classic formulation of the duty of care provides that a director must not only become informed but also put the information to good use.[239] This formulation implicitly recognizes that the standard of conduct (as opposed to the standard of review) for the duty of care is not concerned solely with empty procedural formalities. Instead, the duty of care is about meaningful decisionmaking, which is aided by process but requires more. It requires an openness to the process that is incompatible with insincerity and conflicts of interest. Thus, if the understanding of the duty of care is sufficiently broad, it can encompass the duties of good faith and loyalty.

It would be equally possible to argue that the one fundamental duty is the duty of good faith.[240] After all, the core duty of pursuing the interests of the corporation and its shareholders is perfectly consistent with the duty of good faith, which, broadly understood, is to pursue the interests of the corporation and its shareholders honestly and sincerely, and without intentional misconduct of any kind. Moreover, as demonstrated earlier, much of the law's discussion of fiduciary duties revolves around the notion of good faith.[241]

Good faith is the indispensible prerequisite to the fulfillment of

234. *Id.*

235. *Id.*

236. *Id.* at 808–09.

237. Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

238. *See* Johnson, *supra* note 231, at 806.

239. *See Aronson*, 473 A.2d at 812 ("[D]irectors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with the requisite care in the discharge of their duties."), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

240. The central importance of good faith can be highlighted by the following anecdote:

> In the 1960s, when Delaware was revising its corporation law, Samuel Arsht, a leading figure of the Delaware corporate bar, is said to have proposed that the law be simplified to the following principle: Directors of Delaware corporations can do anything they want, as long as it is not illegal, and as long as they act in good faith.

Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1015 (1997).

241. *See supra* notes 75–77, 185–209 and accompanying text.

fiduciary duties.[242] In fact, it is possible to view the other fiduciary duties as proxies for good faith. A shareholder can always prevail by establishing bad faith on the part of directors. Bad faith is extremely difficult to prove, however. Thus, the duty of care and the duty of loyalty can be seen as tools to ascertain whether the directors are acting in good faith. Of course, merely being careless or conflicted does not, in itself, indicate bad faith; but neither does it result in a breach of fiduciary duty. However, when a director is exceedingly careless—that is, grossly negligent—or has a material conflict *and* cannot establish that the transaction is fair, there is a reasonable inference that his actions have not been taken in the utmost good faith. In other words, gross negligence and unfairness can be considered objective signs of bad faith.[243] When they are established, directors are held liable as if they had acted in bad faith.

Of course, Strine would take issue with such arguments. According to the Vice Chancellor,

> There might be situations when a director acts in subjective good faith and is yet not loyal (*e.g.*, if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally [because a director acting in bad faith is not being loyal to the corporation].[244]

Strine believes this proves that good faith is a subset of loyalty. It does not. The same thing could be said of the relationship between the duties of care and good faith: there might be situations in which a director acts in subjective good faith and is yet not careful (for example, if the director has the intent to benefit the corporation and is grossly negligent), but there is no case in which a director can act in subjective bad faith toward the corporation and act with care (because a director acting in bad faith is not caring for the corporation).[245] Thus, good faith is more than merely a subset of loyalty. It may be a subset of both care and loyalty, but a more reasonable conclusion would be that good faith is different from and yet related to both.[246]

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242. *See supra* notes 166–67 and accompanying text.

243. *Cf. supra* text accompanying note 186.

244. Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003). "A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest." *Id.*; Stone *ex rel.* AmSouth Bankcorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (quoting *Guttman*, 823 A.2d at 506 n.34).

245. *Cf.* Johnson, *supra* note 231, at 808–09.

246. *Cf. infra* text accompanying note 319.

The problem with these claims is that, with a slight tweaking of definitions, the statements can be reversed. All that is required is that good faith be interpreted broadly and that care and loyalty be interpreted more narrowly. Then it reasonably could be said that (1) there might be situations in which a director acts loyally and yet does not act in good faith (for example, if the director is not interested in the transaction but engages in intentional misconduct), but there is no case in which a director can act disloyally toward the corporation and act in good faith (because a director who is disloyal is not acting in good faith); and (2) there might be situations in which a director acts carefully and yet does not act in good faith (for example, if the director follows appropriate procedures but engages in intentional misconduct), but there is no case in which a director can act carelessly toward the corporation and act in good faith (because a director who is careless is not acting in good faith). The plausibility of these statements, like the plausibility of the earlier statements, depends on a willingness to generalize and ignore details.

This demonstrates that such arguments are nothing more than semantics. Just as fiduciary duties generally can be viewed at different levels of abstraction, so too can individual duties be viewed at different levels of abstraction. This conceptual flexibility is what allows one duty to be portrayed as superior to, and encompassing, the others. Because each duty can be characterized broadly or narrowly, however, such claims are inherently unreliable.

I argued above that it was equally possible to consider any of the particular fiduciary duties as the one fundamental duty. The best way to think about the one fundamental duty, however, is to view it as something different from any of them; or rather, as comprising all of them.[247] Conceptually, this single fundamental fiduciary duty can be broken down in different ways at different levels of abstraction depending on the need. Ultimately, the various duties are all related precisely because they are all aspects of the one fundamental fiduciary duty.[248]

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247. *Cf. In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005) ("Fundamentally, the duties traditionally analyzed as belonging to corporate fiduciaries, loyalty and care, are but constituent elements of the overarching concepts of allegiance, devotion and faithfulness that must guide the conduct of every fiduciary.").

248. *See infra* text accompanying note 313.

C. LEVELS OF SPECIFICITY

Beyond the one fundamental fiduciary duty, there are many possibilities.[249] Both Strine and Hill and McDonnell suggest that the next step bifurcates fiduciary duties into care and loyalty based on the potential for director liability.[250] This type of bifurcation seems perfectly reasonable. What is more questionable is the decision to label the categories "care" and "loyalty." It is true that care and traditional loyalty fit those descriptions, but it assumes the conclusion to say that everything in the former category is the duty of care and everything in the latter category is the duty of loyalty. To determine whether that is the case, further consideration is necessary.

The distinction at this second level of abstraction technically is quite small. According to Hill and McDonnell,

> we put into the care category circumstances where we want courts to largely avoid scrutinizing board behavior, such that it is extremely unlikely that directors will ever be held personally liable. Loyalty cases deserve at least a bit of (and sometimes quite a bit of) a closer look from courts.[251]

This suggests that the key distinction concerns the level of judicial scrutiny. That is not quite accurate, however. Whether or not it is a subset of loyalty, the duty of good faith certainly belongs in the same category at the second level of abstraction. Yet good faith does not get nearly the level of scrutiny that loyalty does. From the director's perspective, the review for good faith is quite lenient,[252] while review for loyalty is quite demanding. Nor is the distinction based on the possibility of personal liability. After all, the duty of care can lead to liability as well, *unless* the shareholders have adopted a director exculpation amendment to the corporate charter.[253] The distinction

249. It is worth noting that moving along the spectrum of abstraction/specificity is not discrete, but continuous. Thus, it is inappropriate to number the levels of abstraction or to refer to them as the "next" or "previous" level. They should be referred to as "different" levels of abstraction in order to acknowledge that there may be other possibilities along the way. Nevertheless, for the sake of convenience, I will refer to the first three levels of abstraction that I discuss as the first, second, and third level, respectively. I do not mean to suggest that they are objectively the first, second, and third levels of abstraction.

250. *See* Hill & McDonnell, *supra* note 13, at 1788–89; Strine et al., *supra* note 12, at 634.

251. Hill & McDonnell, *supra* note 13, at 1789.

252. This is true as an initial matter. If the shareholders manage to rebut the presumption of the business judgment rule, however, then the burden that shifts to the directors is quite demanding. *See supra* notes 88–96 and accompanying text.

253. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).

is actually a narrow one, described by Strine as "distinguish[ing] between two forms of director conduct: (1) conduct that . . . should be remediable by an award of monetary damages, and (2) conduct that involves an exculpable or indemnifiable breach."[254]

I would characterize the distinction at the second level of abstraction differently. I believe that the second level distinguishes between situations in which directors merely drop the ball—for example, because they were careless—and those in which directors do something worse—whether they engage in actual misconduct or simply put themselves in a situation where misconduct is more likely.[255] This happens to correspond very well to the likelihood of liability. Although it is a bit more vague, it is also more meaningful.

According to Hill and McDonnell, "One level of abstraction below that, we divide the loyalty category into two parts. One part . . . is traditional loyalty cases . . . . The other part is good faith."[256] This third level of abstraction is consistent with the now-defunct triad of fiduciary duties. It is important to notice that at this level of abstraction, Strine and Hill and McDonnell are in agreement with Eisenberg. The difference is primarily one of semantics. They all agree, more or less,[257] that there are three categories of duties which, at least colloquially, could be labeled care, loyalty, and good faith.[258] The difference is that Strine and Hill and McDonnell would apply the label "duty of loyalty" at the second level and say that traditional loyalty and good faith are both subsets, while Eisenberg might (and I would) apply the label "duty of loyalty" at this third level, making traditional loyalty and good faith independent of each other and on equal footing with care.

Subsequent levels of specificity may be characterized in many different ways.[259] Because the current debate focuses on the first three

254. Strine et al., *supra* note 12, at 634.

255. *See infra* text accompanying note 276.

256. Hill & McDonnell, *supra* note 13, at 1789.

257. The parties disagree on the exact content of good faith. Where Strine would make it entirely subjective, *see* Strine et al., *supra* note 12, at 644, 695–96, Eisenberg would include a significant objective component, *see* Eisenberg, *supra* note 12, at 23, 72. In an even more significant departure, Hill and McDonnell would make it "the vast middle ground" which would cover structural bias. *See* Hill & McDonnell, *supra* note 13, at 1770.

258. According to the *Stone* court, "good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty." Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del 2006).

259. According to Hill and McDonnell, "If we then descend one more level of abstraction, we find that the good faith region in turn subdivides at present into a variety of different factual circumstances

levels of abstraction, I will offer only brief thoughts. A fourth level of abstraction might spell out the contents of each particular duty. For example, according to the *Disney* court, the duty of good faith may consist of the duties to avoid intentional misconduct, intentional violation of law, and conscious disregard of duties, among other things.[260] According to Strine, the duty of care may include the duties of "informedness, prudence, advisedness, preparedness, and diligence."[261] Likewise, the duty of loyalty may consist of the duties to not engage in a self-dealing transaction, to avoid other material conflicts, and to not misappropriate a corporate opportunity.[262] A fifth level could go even further and specify the particular conduct requirements of each duty. Thus, for example, the duty of informedness might include the duties to gather all information that is already available, to use reasonable efforts to generate new information, to read reports, and to participate in board meetings. Subsequent levels could go into even greater specificity. At some point, there is a move beyond the level of general principle, and even specific conduct can be considered a fiduciary duty. Thus, for example, it could be said that, in *Van Gorkom*, the directors had a fiduciary duty to meet for more than two hours.[263] That "duty" was particular to that case, however, and it is not a fair statement of law to say that board meetings generally must last more than two hours.

The insight that fiduciary duties can be viewed at different levels of abstraction helps to explain theories about fiduciary duties that seem to conflict. For example, it reveals that Strine and Eisenberg are not that far apart after all. It also reveals that the question about the precise number of fiduciary duties in corporate law is misleading and ultimately irrelevant. It can be fair to say that there is only one fiduciary duty, or that there are two, or three, or almost any number. It would even be fair to say that there are dozens, or hundreds, or even thousands of duties at sufficiently low levels

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and related standards of review." Hill & McDonnell, *supra* note 13, at 1789. As I argued earlier, *see supra* notes 220–26 and accompanying text, Hill and McDonnell misunderstand the concept of good faith and conflate it with bias. As I will show in the next section, bias is an independent category that deserves equal footing on the third level of abstraction. Thus, much of the work that Hill and McDonnell ascribe to the fourth level of abstraction is actually accomplished in my (modified) third level.

260. *See In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006); *supra* text accompanying note 80 (quoting *Disney*, 906 A.2d at 67).

261. Strine et al., *supra* note 12, at 654–55 (footnotes omitted).

262. *See, e.g.*, Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002); Solomon v. Armstrong, 747 A.2d 1098, 1112–13 (Del. Ch. 1999).

263. *See* Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

of abstraction. Each claim can be true in some respects without making the others wrong in other respects. Of course, in the hands of any capable jurist, it is all irrelevant. As long as the necessary distinctions are preserved—especially the five paradigms for the enforcement of fiduciary duties—it does not matter how the fiduciary duties are numbered or categorized. It is simply a matter of preference.

There are at least two remaining problems that must be dealt with. The framework discussed so far does not seem to account for everything. For example, it does not deal well with hybrid concepts such as bias and intermediate standards of review. I address this concern in the next section. Perhaps more problematic are duties such as the duty of disclosure. Where does such a duty fit in? It has alternatively been described as fitting in with care, loyalty, good faith, or all three.[264] Is this a separate duty, and if not, how should it be dealt with? I address this concern in a subsequent section.

D. FIVE FIDUCIARY DUTIES

Thus far, I have argued that at the highest level of abstraction, there is only one fiduciary duty; at a slightly lower level, there is a bifurcation of fiduciary duties; and at a third level, there is the triad of fiduciary duties—care, loyalty, and good faith. Essentially, the current debate, manifested in the exchange between Strine and Eisenberg, has been about which level of abstraction—the second or the third—is the most appropriate level for discussions of fiduciary duties and for assigning labels such as the duty of loyalty. Is the important distinction that of the second level, such that exculpable duties ought to be labeled the duty of care and all nonexculpable duties the duty of loyalty, or is the more meaningful level the third level, such that a triad of fiduciary duties is more sensible?

There is no doubt that a distinction concerning the potential for liability, like the one at the second level, is an important one.[265] The

264. *See, e.g.*, Malone v. Brincat, 722 A.2d 5, 11 (Del. 1998) ("The duty of directors to observe proper disclosure requirements derives from the combination of the fiduciary duties of care, loyalty, and good faith."); Zirn v. VLI Corp., 621 A.2d 773, 778 (Del. 1993) ("The requirement that a director disclose to shareholders all material facts bearing upon a merger vote arises under the duties of care and loyalty." (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983))); O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 914–15 (Del. Ch. 1999) ("A claim for breach of the fiduciary duty of disclosure implicates only the duty of care when the factual basis for the alleged violation suggests that the violation was made as a result of a good faith, but nevertheless, erroneous judgment about the proper scope or content of the required disclosure.").

265. It would be better if the distinction were about the amount of scrutiny and the possibility of liability rather than merely about exculpability and indemnifiability, see *supra* notes 251–56 and

question is whether it is the most important feature to highlight. On the one hand, it probably is the distinction that is of greatest concern to shareholders and directors alike. On the other hand, it is a highly simplistic distinction, and one that does not tell us very much about the fiduciary duties themselves. Most of the information derived from the second level of abstraction comes not from the distinction itself but from the label assigned to the distinction. Differentiating among duties that can and cannot be exculpated tells us only that some breaches of fiduciary duty are worse than others. It does not tell us how they are worse or how much worse. The labels "care" and "loyalty" are what begin to convey some substantive meaning. Because the term loyalty would be defined capaciously, however, it does not tell us much more than that it is somehow worse than carelessness.[266]

Compare that with the third level. The triadic formulation tells us significantly more about the fiduciary duties themselves. It distinguishes among cases in which directors are negligent—care—those in which directors engage in misconduct—good faith—and those in which directors may or may not have engaged in any misconduct, but in which there can be no confidence in their judgment because they are conflicted—loyalty. Moreover, the third level does not sacrifice much of the simplicity of the second level. It is not very difficult to remember that good faith and loyalty violations are more likely to lead to liability than care violations. Thus, the third level seems to have a descriptive advantage over the second level without much trade off.

And yet, as noted earlier, there is a problem at the third level of abstraction. The triadic formulation does not adequately deal with the complexity of fiduciary duties, especially structural bias and the intermediate standards of review. Hill and McDonnell attempt to deal with this problem at a fourth level of abstraction, as a subset of good faith. As I argued earlier, however, they are mistaken about the nature of good faith, which is completely different from structural bias.[267] Of course, it would be possible to locate structural bias within good faith arbitrarily, but that would raise two difficulties. First, the tidy continuum would be destroyed,

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accompanying text, but it is nevertheless an important distinction. Moreover, as I have suggested, the real distinction focuses not on liability, but on other factors that have ramifications for liability. *See supra* Part IV.C.

266. My characterization of the second level of abstraction is somewhat more descriptive than exculpability, but only about as much as the labels "care" and "loyalty."

267. *See supra* notes 217–25 and accompanying text.

because good faith and structural bias are not located near each other on the spectrum. Second, an unnecessary layer of complexity would be introduced. Already, bifurcation requires Strine and Hill and McDonnell to explain that there are two duties, care and loyalty, but that loyalty can be divided into traditional loyalty and good faith. Structural bias requires that good faith be further divided into intentional misconduct and bias. Thus, rather than a simple list of fiduciary duties, there is a complex structure resembling an outline:

1. care
2. loyalty
   a. traditional loyalty
   b. good faith
      i. intentional misconduct
      ii. structural bias

The sole benefit of this convoluted structure is to highlight the distinction between exculpable and nonexculpable duties.

The problem posed by structural bias can be resolved much more easily, by recognizing that the essence of the third level of abstraction is not the triadic formulation itself, but rather the paradigms for the enforcement of fiduciary duties. A paradigm-centered approach is compatible with the triadic formulation, but extends it. In addition to care (which corresponds to the first paradigm), loyalty (which corresponds to the second paradigm), and good faith (which corresponds to the fourth paradigm), there are two more components (which correspond to the third and fifth paradigms). This approach further distinguishes among cases in which directors are not financially conflicted but are nevertheless structurally biased, and those in which directors make an irrational decision. In this Article, I refer to the latter category as "rationality," and the former category as "objectivity."[268]

This approach shifts the terms of the discussion. Scholars and jurists have been debating whether there are two fiduciary duties or three, but my analysis suggests that a better answer may be five. Thus, it could be said that there is a duty of care, which covers process; a duty of loyalty, which covers conflicts; a duty of good faith, which covers intentional misconduct; a duty of objectivity, which covers bias; and a duty of rationality, which

268. By the term objectivity, I mean nothing more than not influenced by (structural) bias.

covers substance.[269] Admittedly, my approach seems more complex than I would like it to be. Any complexity is merely superficial, however. Moreover, it is unavoidable under the existing law.

A more important criticism is that my approach may seem far-fetched. Are "objectivity" and "rationality" truly fiduciary duties on a par with good faith, as well as care and loyalty? Is it even fair to say that there are duties to avoid structural bias and waste?

A duty to avoid waste does not seem too much of a stretch. Courts may not like to review the substance of business decisions, but this concern is reflected in an extremely lenient standard of review. A duty to avoid structural bias, on the other hand, is more problematic. One of the central claims about structural bias is that it is not avoidable; it is a manifestation of a psychological phenomenon known as ingroup bias.[270] Surely the law cannot require directors to do the impossible. However, my proposed "duty of objectivity" is not exactly a duty to avoid structural bias. Rather, it is a duty to be aware of structural bias and a corresponding obligation to be objectively reasonable under the circumstances.[271]

The concern underlying the duty of objectivity is similar to that underlying the duty of loyalty, but it is different in two important respects. First, it is less direct and severe. Directors may be conflicted, but the conflict does not rise to the level of self-dealing. This is why less is required of directors to escape breach—not entire fairness, but only reasonableness.[272] Second, it is not a situation that can be avoided. Whereas directors can avoid self-dealing transactions altogether and abstain in other situations involving a conflict, structural bias involves situations that are not created by directors.[273] Because directors cannot avoid structural bias, they must remain aware of it and deal with it reasonably. Thus, although objectivity sounds like a subset of loyalty, it more closely resembles care in terms of culpability. This is why I have argued in earlier work that breaches of the duty of objectivity probably should be exculpable.[274] Shareholders

269. *See supra* tbl.

270. *See* Velasco, *supra* note 19, at 860–65.

271. *See supra* tbl.

272. *See* Velasco, *supra* note 19, at 825.

273. *See id.* at 824–25.

274. *See id.* at 914–16. The Delaware Supreme Court decision in *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235, 243–44 (Del. 2009), arguably provides support for this position. In that case, which involved *Revlon* duties, the directors were held to have not breached the duty of loyalty because they had not "knowingly and completely failed to undertake their responsibilities." At most, they had breached only the duty of care, and thus were protected by the exculpation provision in the corporate

should be relegated to injunctive relief.[275] Because the duty of objectivity lies directly between the duties of care and loyalty, the question of exculpability is a close one and reasonable people can disagree. I maintain, however, that the duty of objectivity is a situation in which directors have dropped the ball (by not acting reasonably in the face of bias), rather than having done something worse (such as intentionally engaging in misconduct or putting themselves in a situation where misconduct is more likely).[276] For this reason, it would be more appropriate to place the duty of objectivity, at the second level of abstraction, on the duty-of-care side of the divide.

Somewhat counterintuitively,[277] I believe that the duty of rationality belongs on the loyalty side of the divide. The concept of rationality is often described as a duty of substantive care.[278] Moreover, a bad decision seems more like poor judgment than something worse. As I have pointed out, however, the duty of rationality does not make much sense unless it is understood as a proxy for the duty of good faith.[279] As a result, it should be treated in the same way as good faith.[280] Because the duty of good faith is not exculpable, it follows that the duty of rationality should not be, either.

Scholars, attorneys, and judges need to discuss fiduciary duties efficiently, without the theoretical morass that fascinates scholars. Thus, the law should discuss fiduciary duties, at least by default, in the manner that is most helpful and productive. Labels ought to be assigned so as to balance the competing goals of description and simplicity. By this criterion, the third level of abstraction, which focuses on the paradigms for enforcement, is superior to the second level, which merely focuses on the potential for liability. The second level conveys very little information and

charter. *Id.* at 239–40. In other words, the reasonableness of their actions was protected by exculpation, while any intentional misconduct was not.

275. Injunctive relief can be especially helpful under the *Revlon* model of enforcement, which allows courts to undo contractual terms under appropriate circumstances. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 50–51 (Del. 1994).

276. *See supra* note 255 and accompanying text. Although misconduct may be more likely because of bias, that is unavoidable and not the result of director action.

277. I suspect that most people would assume that objectivity, which is similar to loyalty, should not be exculpable, and that rationality, which is similar to care, should be exculpable. Thus, my conclusions may appear counterintuitive.

278. *See supra* note 97 and accompanying text.

279. *See supra* notes 107–09 and accompanying text.

280. Another way of saying this is that, for purposes of section 144, the duty of rationality is a subset of the duty of good faith; or, more precisely, wasteful action is not action taken in good faith.

provides only superficial simplicity. The third level conveys significant information with minimal complexity. Ultimately, it seems more helpful to say that there are five fiduciary duties, some of which are more likely to lead to liability than others, than to say that there are two fiduciary duties, but with multiple paradigms for enforcement within them. Thus, if the question about the number of fiduciary duties must be asked, the best answer is five.

E. The Danger of Collapsing the Standards of Review

Thus far, I have argued that the question—How many fiduciary duties are there in corporate law?—is misleading and ultimately irrelevant. Because fiduciary duties can be understood at various levels of abstraction, the question can be answered in many different ways, each of which is correct in some respects and inadequate in others. Moreover, the answer does not matter as long as the inherent complexity of the law of fiduciary duties, including the five paradigms for enforcement, is preserved. Nevertheless, I argued that, if the question must be asked, the best answer is five. Although this answer, too, is imperfect, there is at least one strong reason why it might be important to say that there are five fiduciary duties rather than two: it may be difficult to preserve the intricacies of the law if it is insisted that there are only two fiduciary duties.

The claim that there are only two fiduciary duties is rooted in a desire for simplicity. There is no great need for simplification, however, because the numbers at issue are all relatively small. Five duties are not especially more complex than two, and certainly not beyond the ability of practicing attorneys and sitting judges. Moreover, bifurcation only leads to a false sense of simplicity.[281] Eventually, jurists will realize that simplification is futile unless the simplicity extends to substance as well as form. Inevitably, there will be a push to reduce the number of paradigms of enforcement. The only logical stopping point would be to have one standard of review per fiduciary duty. Thus, the desire for simplification poses a great risk of oversimplification.

For example, traditional loyalty and good faith could be collapsed into one standard of review under a broad duty of loyalty. There are three ways this can be done. First, the fairness test, or the second paradigm, could be employed in cases involving issues of good faith.[282] Under this scenario,

281. *See supra* Part IV.D.
282. This would be difficult to do. *See infra* notes 333–42 and accompanying text.

intentional misconduct would get considerably stricter review. Second, the intentional misconduct test, or the fourth paradigm, could be employed in cases involving issues of traditional loyalty. Under this scenario, self-dealing would get considerably less review. Finally, an intermediate standard of review, somewhere between fairness and intentional misconduct, could be employed in all cases. Under this scenario, good faith would be overenforced and loyalty would be underenforced. In each case, precision would be sacrificed for the benefit of simplicity.

Similarly, the duty of care and the duty of rationality could be collapsed into one standard of review under a broad duty of care.[283] One possibility would be to employ the waste test, or the fifth paradigm, in cases involving issues of care. Under this scenario, review of process would become even more lenient. Another possibility would be to employ the gross negligence test, or the first paradigm, to issues of substance. Under this scenario, substance would get significantly greater review. A third possibility would be to develop a new intermediate standard of review and employ it in all cases. Under this scenario, both process and substance suffer to some extent.[284] In any event, precision would once again be sacrificed for the benefit of simplicity.

The desire for simplicity is not imaginary. Scholars have suggested that the law of fiduciary duties is becoming too complex.[285] I myself have argued for a simplified approach to structural bias,[286] and my current proposal would have only one standard of review per fiduciary duty (although I would have more duties). Thus, I believe that the potential for oversimplification should not be ignored.

In an article coauthored with then–Vice Chancellor, now Justice, Jack Jacobs and Vice Chancellor Strine, Chancellor William Allen proposes a reduction in the number of standards of review.[287] Allen argues that "a rigorous functional evaluation of existing corporate law standards of review will clarify their application, reduce their number, and facilitate the task of

283. *See supra* notes 97, 103 and accompanying text.

284. A fourth possibility would be to abandon review of substance altogether, but this is something that the courts seem to be unable to do. *See supra* notes 102–03 and accompanying text.

285. *See, e.g.*, William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1291–95 (2001).

286. *See* Velasco, *supra* note 19, at 845, 870–83.

287. *See* Allen, Jacobs & Strine, *supra* note 285. For the sake of convenience, I will refer to the coauthors collectively as "Allen."

corporate advisors and courts."[288] In the end, he proposes that there be three basic standards of review corresponding roughly to the first, second, and third paradigms for enforcement.[289] It is worth noting, however, that good faith was not a very well-developed concept at the time of the article's publication. Presumably, Allen would add a fourth standard of review corresponding to the fourth paradigm if he were making the argument today. Thus, in general, the difference between my approach and his is that I would recognize a fifth standard of review for waste, while he would do away with the concept.[290]

Aside from the obvious difference that Allen does not recognize five fiduciary duties, his proposal is structurally similar to mine. There are noteworthy differences, however. For example, Allen argues that "the relationship between the *Blasius* and the *Unocal*[] doctrines is a fruitful subject for some doctrinal pruning,"[291] and that the "'flavoring' difference" between the two doctrines does not "justif[y] the added doctrinal complexity created by continuing *Blasius* as a separate review standard."[292] This conclusion is deeply problematic in two respects. First, it improperly locates *Blasius* within the third paradigm (that is, reasonableness) rather than the fourth (that is, intentional misconduct). This is entirely understandable because it reflects how the courts currently view *Blasius*, but it is nevertheless misguided. Second, it erroneously suggests that there is only a "'flavoring' difference" between the two standards that could be remedied by "trusting the courts"[293] to employ a "gimlet eye."[294] Unfortunately, there may be more to Allen's claim than I would care to acknowledge. As I have argued in earlier work, the *Unocal* test has been watered down to the point where its version of the reasonableness test is not much different from a test for intentional misconduct.[295] In addition, the courts seem to be backing off the compelling justification standard to

288. *See id.* at 1292.

289. *See id.* at 1293.

290. *See id.* at 1317–18; William T. Allen, Jack B. Jacobs & Leo E. Strine Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and Its Progeny as a Standard of Review Problem*, 96 Nw. U. L. REV. 449, 457 (2002). It is worth noting that, despite occasional rhetoric to the contrary, Allen does not deny that there is a fifth paradigm. *See* Allen, Jacobs & Strine, *supra* note 285, at 1296 ("Where the business judgment standard applies, a director will not be held liable for a decision—even one that is unreasonable—that results in a loss to the corporation, *so long as the decision is rational*." (emphasis added)).

291. Allen, Jacobs & Strine, *supra* note 285, at 1311.

292. *Id.* at 1315.

293. *Id.* at 1320 (emphasis omitted).

294. *Id.* at 1316.

295. *See* Velasco, *supra* note 9, at 416–20.

the point where it may resemble a reasonableness test.[296] Thus, there may be less difference between *Unocal* and *Blasius*, as applied, than I would care to admit. Yet there certainly is a great deal of difference, at least in theory, between the third paradigm—demanding reasonableness in cases involving structural bias—and the fourth—demanding a compelling justification for intentional misconduct. Of course, the two tests may sometimes lead to the same result, but they do not convey the same concerns. As a result, over the long run, there almost certainly would be significant differences in outcomes if there were two separate tests.[297]

Likewise, Allen would incorporate the *Revlon* test into *Unocal*.[298] According to Allen, "Except for requiring the court to evaluate the reasonableness of the directors' action against the singular objective of current value maximization, the *Revlon* standard differs little from the *Unocal* standard in practical application."[299] The problem with this claim is the enormity of the exception. I would agree that the courts *should* reach the same conclusions under a true reasonableness test as they would under *Revlon*. After all, if the company is for sale, it would be reasonable to seek the best price. However, it is not at all clear that the courts *would* reach the same conclusions under the existing *Unocal* standard.[300] The extent of deference currently afforded to directors suggests that their conduct would not be judged against a "singular objective."

My point here is not to criticize Allen for eliminating too many standards of review. Rather, it is only to demonstrate that simplification easily can lead to oversimplification. Assertions that sound plausible in the abstract may not work out as expected. The best way to avoid this type of mistake is to structure the law of fiduciary duties so as to make oversimplification unlikely. The desire to associate each fiduciary duty with exactly one standard of review can be mitigated by declaring that there are five fiduciary duties.

296. *See* Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) ("*Blasius*' burden of demonstrating a 'compelling justification' is quite onerous, and . . . therefore [should be] applied rarely."); Allen, Jacobs & Strine, *supra* note 285, at 1311–16.

297. *See, e.g.*, MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003). In that case, the Chancery Court had rejected the plaintiff's *Blasius* claim and upheld the defendants' actions under *Unocal*. *Id.* at 1121. The Delaware Supreme Court reversed, holding for the plaintiffs under *Blasius*. *Id.* at 1332–33. In this case, at least, the difference between the *Unocal* and *Blasius* standards was significant.

298. *See* Allen, Jacobs & Strine, *supra* note 285, at 1320–21.

299. *Id.* at 1321.

300. *Cf.* Velasco, *supra* note 19, at 847–48 n.111 ("The *Revlon* decision can be seen either as an entirely new test or merely as a specific application of *Unocal*.").

F. THE COMPLEX RELATIONSHIP AMONG FIDUCIARY DUTIES

In this section, I demonstrate that the inherent complexity of fiduciary duties extends beyond a mere number. I argue that the relationship among the various fiduciary duties is also complex. Thus, it is inadequate to describe fiduciary duties as lying on a linear continuum.

The inadequacy of linear thinking becomes evident when one attempts to plot the fiduciary duties along a continuum. Hill and McDonnell's attempt is illustrative. They view good faith as occupying the middle ground between care and loyalty.[301] As discussed earlier, this does not work.[302] The explanation for their error is that they saw three categories of fiduciary duties—care, traditional loyalty, and good faith—and three categories of standards of review—business judgment, fairness, and intermediate scrutiny—and assumed that they matched up nicely. Because intermediate standards of review clearly lie between fairness and business judgment, they concluded that good faith lies between care and loyalty. They did not realize that there are more than three categories of fiduciary duties and more than three categories of standards of review.

Even setting aside rationality and waste, Hill and McDonnell should have recognized four categories of fiduciary duties and of standards of review. While care corresponds to business judgment and loyalty corresponds to fairness, good faith does not correspond to intermediate scrutiny. Rather, good faith requires a different standard of review and intermediate scrutiny demands a different fiduciary duty. Had Hill and McDonnell realized this, they could have organized their continuum differently. Even with this insight, however, it is not obvious how they should have done so. The relative positions of the duties of care and loyalty are straightforward; the positions of the other three fiduciary duties are more complicated.

For example, if fiduciary duties are plotted linearly based on the likelihood of liability, one possible sequence would be the following:

Liability Likely ⟷ Liability Unlikely

Loyalty—Objectivity—Care—Good Faith—Rationality

The stricter standard of review means that loyalty is more likely to lead to

301. *See* Hill & McDonnell, *supra* note 13, at 1770.
302. *See supra* note 215 and accompanying text.

liability than care. Objectivity is judged by an intermediate standard of review and therefore falls between the two. Finally, good faith and rationality are judged under extremely deferential standards of review and therefore are very unlikely to lead to liability.

If we factor in the likelihood of exculpation, however, the sequence would change significantly. It might look as follows:

Exculpability Unlikely ⟷ Exculpability Likely

Loyalty—Good Faith—Rationality—Objectivity—Care

Loyalty is most likely to lead to liability, while care—which is exculpable—is least likely to do so. Good faith may also lead to liability, but is less likely to do so than loyalty because of the burden that the plaintiffs must bear. Finally, if, as I have argued, objectivity is exculpable and rationality is not, then rationality is more likely to lead to liability than objectivity—even though it is very unlikely to do so.[303]

Likelihood of liability is only one possible way of organizing fiduciary duties on a continuum. Another possibility is the culpability of the conduct covered by the duty. Based on this criterion, the sequence should be the following:

Most Culpable ⟷ Least Culpable

Good Faith—Loyalty—Objectivity—Care—Rationality

Clearly, intentional misconduct is the most culpable form of behavior. Rationality—or making a bad substantive decision—is the least culpable.[304] Loyalty involves conduct—conflicted action—that is more culpable than care,[305] and objectivity—biased action—lies somewhere between the two.

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303. If I am wrong on either point, the sequence may vary. Other possibilities include:
Loyalty—Good Faith—Objectivity—Care—Rationality
Loyalty—Objectivity—Good Faith—Care—Rationality
Loyalty—Good Faith—Rationality—Objectivity—Care
Loyalty—Objectivity—Good Faith—Rationality—Care

304. On the other hand, if the duty of rationality is considered a proxy for the duty of good faith, *see supra* note 109 and accompanying text, it becomes difficult to locate on the spectrum.

305. *See, e.g.*, Allen, Jacobs & Strine, *supra* note 285, at 1301–02; Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 486 (1992) ("[T]he law has always dealt more strictly with the unfaithful servant than with the careless one."); Strine et al., *supra* note 12, at 634.

There are other possibilities as well. Fiduciary duties may be organized based on the burden shareholders bear to rebut the presumption of the business judgment rule. Based on this criterion, the sequence would be as follows:

Lightest Burden ⟷ Greatest Burden

Loyalty—Objectivity—Care—Good Faith—Rationality

The lightest burden is associated with the duty of loyalty, where the shareholders must prove only a situation rising to the level of self-dealing. The greatest burden is under rationality, where the shareholders must prove that the substance of a decision is so bad as to be utterly irrational and amount to waste. In between the two is care, where the shareholders must establish gross negligence. Objectivity is more demanding than loyalty because the shareholders must establish not only a situation involving bias, but also unreasonableness. And good faith is less demanding than rationality because intentional misconduct is more likely than utterly irrational behavior.[306]

Likewise, fiduciary duties may be organized based on the subsequent burden on the directors. The sequence might be as follows[307]:

Most Demanding ⟷ Least Demanding

Rationality—Care—Good Faith—Loyalty—Objectivity

Rationality would seem to be the most demanding because, once the shareholders have established that a decision was utterly irrational and amounted to waste, there would seem to be nothing left to do but to argue the extent of damages. The same is true for care, but it might be easier to establish a lack of damages resulting from gross negligence than from

306. On its face, intentional misconduct might seem to be as difficult to prove as irrationality, and arguably more difficult. The duty of good faith, however, covers more than just malicious behavior. It also covers other intentional conduct that the law deems misconduct, such as intentional violations of law. As a result, the burden on the shareholders with respect to the duty of good faith is not nearly as great as the burden with respect to the duty of rationality.

307. This spectrum is more tentative for two reasons. First, as to some duties, the business judgment rule is rarely, if ever, rebutted, so the courts have not had very many opportunities to flesh out the issue. *See supra* note 106, *infra* note 330 and accompanying text. Second, the law seems to be in doubt, as will be discussed in the next part of this Article. *See infra* notes 327–28 and accompanying text.

waste.[308] The burden under the duty of good faith would be almost as bad. Once the shareholders have established intentional misconduct, the directors would have the opportunity to show a compelling justification. This would be extremely difficult, but not necessarily impossible.[309] Next is the duty of loyalty. The directors must establish that the transaction was not only fair to the corporation and its shareholders, but also "entirely" or "intrinsically" fair, both as to process and substance. Last is the duty of objectivity. The directors must convince the court that their conduct was not unreasonable.[310]

In short, there are many different ways of organizing fiduciary duties. The sequence varies greatly depending on whether they are organized based on likelihood of liability, culpability, or burdens of proof. Moreover, other criteria could be imagined. Each possibility reveals different relationships among the various fiduciary duties. Thus, adopting one linear framework as the definitive model does not do the law justice. Various frameworks can be equally valid even though they lead to conflicting results. What is needed is a more robust model for conceptualizing fiduciary duties. In the next section, I propose such a model.

G. EVERY ACTION IMPLICATES EVERY FIDUCIARY DUTY

In the previous section, I demonstrated that the relationship among the various fiduciary duties is complex and cannot be represented adequately on a single linear continuum. I now suggest that the best way to understand fiduciary duties is to visualize them as Venn diagrams.[311] There are five intersecting closed curves, each with their own realm but which intersect each other as well. This model highlights at least two important characteristics of fiduciary duties. First is the fact that they are capable of relating to each other in many different ways. Second is the fact that there

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308. Under current Delaware law, if the shareholder can rebut the presumption of the business judgment rule, the directors must prove entire fairness. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1993). Nevertheless, the inquiry may turn on the question of damages. *See, e.g.*, Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1176–78 (Del. 1995).

309. *See* Chesapeake Corp. v. Shore, 771 A.2d 293, 330 (Del. Ch. 2000); *infra* notes 336–39 and accompanying text.

310. At least this is true under my proposed test for the third paradigm. *See supra* notes 67–73 and accompanying text.

311. Venn diagrams are usually pictured as three overlapping circles. This image is sufficient to convey the general sense. It is possible to create Venn diagrams for more than three sets. *See generally* Wikipedia, the free encyclopedia: Venn diagram, http://en.wikipedia.org/wiki/Venn_diagram (last visited Aug. 4, 2010) (illustrating extensions to higher numbers of sets).

is some independent realm for each fiduciary duty, but also significant overlap among them. Together, these characteristics reveal many connections among fiduciary duties without suggesting that any one perspective is uniquely correct.

In my proposed approach, each closed curve represents *not* particular conduct, circumstances, or cases, but rather a particular aspect of, or concern with respect to, fiduciary duties. Ultimately, there is one fundamental fiduciary duty—to pursue the interests of the corporation and its shareholders—but that core duty can be divided into at least five different concerns. Directors should make good substantive decisions for shareholders.[312] Directors should employ a good decisionmaking process. Directors also should avoid obstacles to the decisionmaking process, such as bias and conflicts. And, of course, directors should avoid intentional misconduct. In other words, the duty of care represents the concern that the directors pursue the interests of the corporation and its shareholders *carefully*; the duty of loyalty represents the concern that they do so *loyally* (without conflicts); the duty of objectivity represents the concern that they do so *reasonably* (despite bias); the duty of good faith represents the concern that they do so *honestly* (without misconduct); and the duty of rationality represents the concern that they do so *rationally* (without waste).[313]

The ramifications of this should be clear: every action by a director implicates each of the various fiduciary duties. Strine recognizes this fact. He acknowledges that "every act in every context implicates the duty of loyalty" and "every act by a director implicates the duty of care."[314] This is true not only at the second level of abstraction, where there are two duties, but also at the third level, where there are five.[315]

In a sense, fiduciary duties are based not on the directors' conduct but on the shareholders' concerns. Any particular conduct can fall within the ambit of any or all of the fiduciary duties depending on the circumstances that are relevant to the litigation. For example, assume a hostile takeover

312. Of course, because of a lack of judicial competence to review business decisions, this aspect is deemphasized.

313. *See supra* text accompanying note 248.

314. Strine et al., *supra* note 12, at 639. Strine downplays the breadth of the principle, however, by emphasizing the duty of loyalty, *see id*. at 634, 636, 639, and deemphasizing the duty of care, *id*. at 639 ("[B]ecause a loyal director must try to perform her acts with care . . . .").

315. It would not be true at lower levels of abstraction, where specific conduct can be considered a fiduciary duty.

situation in which directors adopt a new variant of the poison pill.[316] How should this conduct be reviewed? The first thought would be to turn to the duty of objectivity for the appropriate standard of review. This is a good assumption. However, the directors' actions can violate any or all of the fiduciary duties. For example, assume further that the directors, for the sole purpose of preserving their jobs, specifically adopt the new poison pill in order to block a transaction that they know would be much better for shareholders. These directors clearly have violated the duty of objectivity by not reasonably overcoming their bias—but they also have violated the duty of rationality by knowingly making a very bad decision, the duty of care by not implementing a process intended to lead to a good decision, the duty of loyalty by not being entirely fair in the face of a conflict, and the duty of good faith by engaging in intentional misconduct. They have violated all five duties at once! The theory or theories that the shareholders will pursue in court will depend on the evidence they can offer. In this situation, the easiest standard for the shareholders to meet seems to be reasonableness: the situation is one involving structural bias, so they have to prove only that the transaction was unreasonable. If they have enough evidence—for example, a record of a meeting where directors admitted to misconduct—they can pursue other theories as well. In real life, however, it is not easy to prove violations of most fiduciary duties. Fortunately, a shareholder can prevail by proving breach of any one duty.[317]

Another example would be the duty of disclosure. As discussed earlier, this duty has been characterized as part of all three court-recognized fiduciary duties.[318] One might argue that this suggests that disclosure is actually a separate duty, much like good faith.[319] This is not the case, however. At a very low level of abstraction, disclosure might be characterized as a fiduciary duty, but not at the second or third levels. Rather, at higher levels of abstraction, disclosure constitutes conduct that is subject to each of the fiduciary duties. Thus, inadequate disclosure can be a breach of any or all of the duties, depending on the circumstances. Assume, for example, that directors knowingly commission a faulty study in order to justify a false disclosure that will benefit them substantially. The most obvious violation is the duty of good faith, because there was dishonesty that was intentional. There is also a violation of the duty of loyalty,

316. For a description of the poison pill, see Julian Velasco, *Just Do It: An Antidote to the Poison Pill*, 52 EMORY L.J. 849, 856–68 (2003).

317. Of course, shareholders will not recover damages if the duty is exculpable.

318. *See supra* note 264 and accompanying text.

319. *Cf. supra* text accompanying note 246.

however, because there was a material conflict together with unfairness. There is a violation of objectivity, because the directors acted unreasonably in the face of bias. In addition, there is a violation of the duty of care, because they knowingly commissioned a faulty study. Finally, if the result is sufficiently egregious, there may be a violation of the duty of rationality. Depending on the circumstances, there may or may not be enough evidence to pursue each of these theories. Theoretically, at least, inadequate disclosure can violate any or all of the fiduciary duties.

Thus, the appropriate way to think about fiduciary duties is not that certain conduct will fall within certain duties; there just happens to be a nice fit in many cases.[320] Rather it is the concern being pursued by the shareholders that determines which duty is litigated. Once director conduct has been called into question, the concern must be identified: Was the conduct intentional? Was it careless? Was it biased? Was it conflicted? Or was it so bad that liability should follow? Ultimately, the one fundamental fiduciary duty is involved. The individual fiduciary duties are simply different ways of determining whether there was a breach.

This approach to fiduciary duties helps to explain two matters that are somewhat problematic under more conventional approaches. The first is exculpation. The exculpability of some fiduciary duties and not others suggests that the law is indifferent to certain fiduciary duties.[321] This is theoretically troubling. It might be fine to suggest that the law is more concerned about certain fiduciary duties than others, but it seems unacceptable to suggest that the law is indifferent to something that it considers a fiduciary duty. However, if there is only one fiduciary duty and what are commonly called fiduciary duties reflect different aspects of that one duty and the type of evidence that can be offered in support of a claim of breach, then exculpation is less problematic. Exculpation does not suggest that the law is indifferent to anything. Rather, it only reflects the judgment that the remedies available to the shareholders should vary depending on the concern at hand and the available evidence. Far from being problematic, this seems eminently sensible.

In addition, this approach to fiduciary duties does a better job of

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320. For example, self-dealing fits well with loyalty, takeovers fit well with structural bias, and sloppiness fits well with care.

321. *See, e.g.*, John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1650 (1989) ("While the duty of loyalty is at the core of fiduciary duties, the duty of care seems more marginal."); Johnson, *supra* note 140, at 28.

explaining *Caremark*[322] duties than does *Stone*. Despite what the Delaware Supreme Court suggests, the *Caremark* duty to monitor seems rather obviously to be a component of the duty of care.[323] For *Stone* to reposition the duty to monitor under the duty of loyalty (via the duty of good faith) was not only surprising, but also disturbing. Essentially, the court converted a duty of care claim, which the legislature had determined should be exculpable, into a duty of loyalty issue, which is not.[324] Understood in this way, *Stone* becomes an example of inappropriate judicial activism. My approach, on the other hand, makes better sense of the holding. The duty to monitor is not a fiduciary duty at the third level of abstraction; it is only conduct. As such, a failure to monitor is capable of violating any of the fiduciary duties, depending on the circumstances. The Delaware statute does not permit exculpation of the duty to monitor, but only of the duty of care.[325] To the extent that a failure to monitor reflects carelessness, it remains exculpable. If the failure to monitor reflects intentional misconduct, however, it also violates a duty of good faith and is not exculpable. This approach does not entail judicial activism. It fully respects both the letter and the spirit of the exculpation statute.

In short, the law of fiduciary duties is inherently complex. Fiduciary duties should not be forced into simplistic frameworks. Rather, the richness of the relationships among them should be acknowledged and respected. The various fiduciary duties represent different aspects of the one fundamental fiduciary duty. Thus, although they are independent of each other, they are also necessarily related and overlap with one another. Nevertheless, each of the fiduciary duties at the third level of abstraction, and each of the five paradigms for enforcement, has an important role in the law of fiduciary duties.

H. SUMMARY

This part addresses how fiduciary duties ought to be understood. The most important insight is that fiduciary duties can be viewed at varying

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

323. That is how the author of the opinion, Chancellor Allen, characterized it. *See id.* at 971; WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 279 (2003); Hill & McDonnell, *supra* note 13, at 1777–78; Johnson, *supra* note 231, at 831. Even *Stone* acknowledges that *Caremark* did not explicitly characterize itself otherwise. *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (2006).

324. Strine insists that this is not what happens under *Stone*. *See* Strine et al., *supra* note 12, at 686–88.

325. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).

levels of abstraction. Thus, conflicting assertions about fiduciary duties can be correct in different respects. At the first and highest level of abstraction, there is only one fundamental fiduciary duty: to pursue the interests of the corporation and its shareholders. At a second level of abstraction, that core duty can be divided into two categories based on culpability or the likelihood of liability. At a third level of abstraction, fiduciary duties can be divided based on the paradigms for enforcement, which expands on the triadic formulation. At the fourth and lower levels of abstraction, specificity increases, eventually to the point where specific conduct can be considered a fiduciary duty.

The current debate about the number of fiduciary duties essentially revolves around the question of which level of abstraction, the second or the third, is the appropriate default level for discussions of fiduciary duties. I argue that the answer does not truly matter as long as the complexity of the law—especially the five paradigms for enforcement—is preserved. I also argue, however, that the third level of abstraction is superior because it is much more descriptive without being overly complex. Moreover, the conclusion that there are two fiduciary duties may lead to a dangerous oversimplification of the law. Thus, the best answer to the question—How many fiduciary duties are there in corporate law?—is that there are five: in addition to care, loyalty, and good faith, there are objectivity and rationality.

Furthermore, fiduciary duties cannot be described adequately in simple terms. The law is too complex, and there is too much overlap among fiduciary duties to permit this. Thus, fiduciary duties should be conceptualized not as a linear continuum, but as occupying a two-dimensional area, much like a Venn diagram. Each fiduciary duty represents not particular conduct on the part of directors, but rather an aspect of the one fiduciary duty that concerns the shareholders. Thus, every action by a director implicates every fiduciary duty and theoretically can violate any or all of them depending on the circumstances and the evidence that the shareholders are able to offer. This approach gives real significance to the notion that there is one fundamental fiduciary duty while preserving the richness and nuance of the law.

V. A UNIFIED STANDARD OF REVIEW?

It is commonly thought that breaches of the duty of care are reviewed under the business judgment rule while breaches of the duty of loyalty are reviewed under the entire fairness test. This is not how it works in

Delaware; at least not since 1993. In that year, the Delaware Supreme Court announced a unified test for the review of breach of fiduciary duty. Now, both the business judgment rule and the entire fairness test are applicable to each and every claim of breach of fiduciary duty.

In this part, I consider how my approach to fiduciary duties would work in Delaware. In Section A, I describe and distinguish the two models for the relationship between the business judgment rule and the entire fairness test. In Section B, I demonstrate that the Delaware model is inherently problematic, but that my five-duty approach works at least as well as Delaware's own approach. In Section C, I describe how my approach would work under the more traditional model. I also argue that the traditional model is superior and that Delaware should abandon its unified test.

A. TWO MODELS

There are two possible models for the relationship between the business judgment rule and the entire fairness test. The first, which I call the "Traditional Model," is the relationship that they had before 1993, and that they still have in many people's minds. The second, which I call the "Delaware Model," is the relationship that was developed in the case of *Cede & Co.*[326]

Under the Traditional Model, the business judgment rule and the entire fairness test are independent of each other. They are two distinct standards of review. Cases involving duty of care claims are evaluated under the business judgment rule, while cases involving duty of loyalty claims are evaluated under the entire fairness test. Under the Delaware Model, the business judgment rule and the entire fairness test are intimately related. Together, they form a unified standard of review. Every case involving a fiduciary duty claim begins with the business judgment rule and ends with the entire fairness test. The business judgment rule provides a presumption that the directors have satisfied their fiduciary duties. If the shareholders rebut this presumption, the directors bear the burden of proving that the transaction was fair. This is true not only of duty of loyalty claims, but also of duty of care claims.

At the present time, the Delaware Model appears to be the law of Delaware. The Delaware Model has been the subject of much criticism,

326. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

however. This criticism comes not only from scholars,[327] but also from Delaware judges writing extrajudicially.[328] Moreover, because it is rare for a shareholder to overcome the presumption of the business judgment rule in a duty of care case, the Delaware courts have not had many opportunities to apply the Delaware Model after *Cede & Co.* Thus, it is not clear that the Delaware Model is settled law in Delaware.

In most cases, there is not much practical difference between the Delaware Model and the Traditional Model. In duty of loyalty cases, the presumption of the business judgment rule is easily rebutted by a self-dealing transaction, without more,[329] and litigation focuses on the entire fairness test. In duty of care cases, the presumption of the business judgment rule is rarely rebutted, so the entire fairness test never comes into play.[330] In fact, since *Cede & Co.*, there has not been a single duty of care case in Delaware in which the presumption of the business judgment rule was rebutted and the entire fairness test was applied. Thus, for practical purposes, the Traditional Model is a fair, if not entirely accurate, description of Delaware law.

Beyond this superficial level, however, the distinction becomes increasingly important. For example, in cases where the difference matters, it can be significant. Moreover, as the number of fiduciary duties increases from two to five, it becomes less fair to say that the Traditional Model and the Delaware Model are functionally equivalent. In the remaining sections, I will consider the ramifications of the two models for my approach to fiduciary duties.

B. FIVE FIDUCIARY DUTIES UNDER THE DELAWARE MODEL

My approach to fiduciary duties is compatible with the Delaware

327. *See, e.g.*, Bishop, *supra* note 12, at 918–19; Johnson, *supra* note 101, at 630–37.

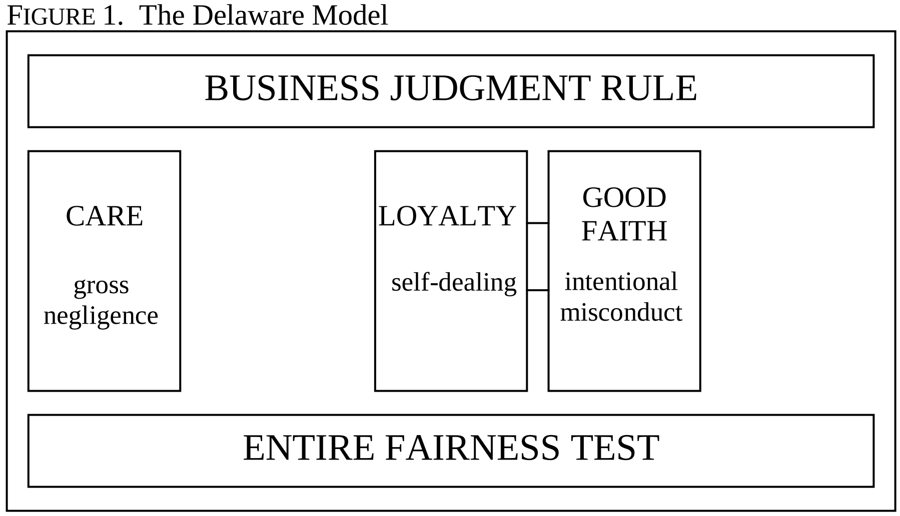
328. *See, e.g.*, Allen, Jacobs & Strine, *supra* note 285, at 1301–05; Symposium, *Judicial Standards of Review of Corporate Fiduciary Action*, 26 DEL. J. CORP. L. 995, 1002–04 (2001) (remarks of Vice Chancellor, now Justice Jacobs).

329. *See* Velasco, *supra* note 19, at 835. At one point, the court in *Cede & Co.* seems to disagree: "Provided that the terms of 8 Del. C. § 144 are met, self-interest, alone, is not a disqualifying factor even for a director. To disqualify a director, for rule rebuttal purposes, there must be evidence of disloyalty." *Cede & Co.*, 634 A.2d at 363. The court's comment refers not to the entire fairness test itself, however, but rather to the effect of one director's conflict to a cleansing vote under section 144. *Id*.

330. Before *Van Gorkom*, there were few instances, if any, of liability under the duty of care. *See* Strine et al., *supra* note 12, at 641 n.24 ("Before [*Van Gorkom*], the duty of care had largely an admonitory, rather than enforceable, basis in American corporate law.").

Model. The Delaware Model provides that every claim of fiduciary duty begins with the business judgment rule and ends with the entire fairness test. In between the two are a number of filters pursuant to which the shareholders may rebut the presumption of the business judgment rule. *Cede & Co.* contemplated that there would be three filters, one for each of the triads.[331] In order to rebut the presumption with respect to the duty of care, the shareholders must establish gross negligence. In order to rebut the presumption with respect to the duty of loyalty, the shareholders must establish self-dealing. In order to rebut the presumption with respect to good faith, the shareholders must establish intentional misconduct. Thus, the Delaware Model may be visualized as follows:

FIGURE 1. The Delaware Model

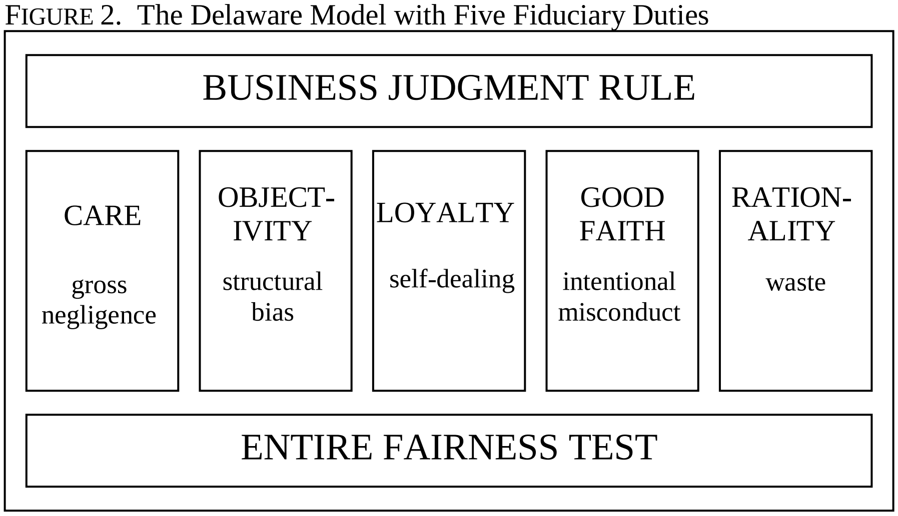


Even at this superficial level, my approach fits in more neatly than does Delaware's own approach, as embodied in *Stone* and *Unocal*. With appropriate caveats, I claim that there are five fiduciary duties. This approach can easily accommodate the Delaware Model. All that is required is having five filters instead of three in between the business judgment rule and the entire fairness test. There would be one filter for each fiduciary

331. *See Cede & Co.*, 634 A.2d at 361 ("To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the *triads* of their fiduciary duty—good faith, loyalty, or due care."). *But see id.* at 371 ("A breach of either the duty of loyalty or the duty of care rebuts the presumption that the directors have acted in the best interests of the shareholders, and requires the directors to prove that the transaction was entirely fair.").

duty which, in turn, represents a paradigm for enforcement. Thus, in addition to the three methods contemplated in *Cede & Co.*, the shareholders could rebut the presumption of the business judgment rule with respect to the duty of objectivity by establishing unreasonableness, or, with respect to the duty of rationality by establishing waste. The basic framework of the Delaware Model suffers no disruption. My approach under the Delaware Model could be visualized as follows:

FIGURE 2. The Delaware Model with Five Fiduciary Duties



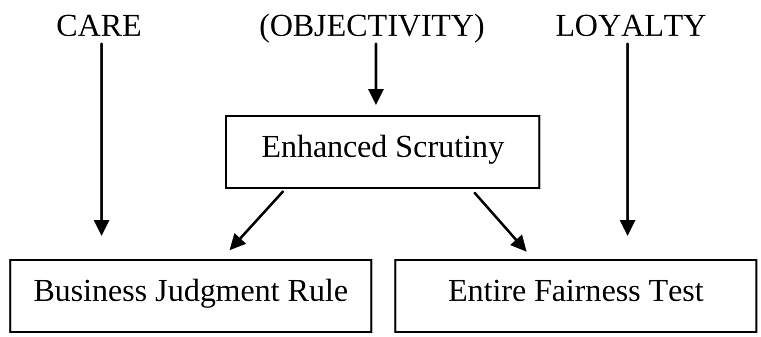
Compare Delaware's own approach. Under *Stone*, the three filters contemplated by *Cede & Co.* remain intact. There is no neat correlation between filters and fiduciary duties, however. Rather, the presumption of the business judgment rule is rebuttable in two ways with respect to the duty of loyalty and in a third way with respect to the duty of care. This may not be especially complex, but it is unnecessarily so.

More importantly, the duty of objectivity, structural bias, and the intermediate standards of review are not accounted for. Under *Unocal*, enhanced scrutiny cannot be described as a filter between the business judgment rule and the entire fairness test. Rather, it is characterized as a "threshold" inquiry, "before the protections of the business judgment rule may be conferred."[332] This simply does not make sense within the framework of the Delaware Model. It reflects the fact that *Unocal* was decided before *Cede & Co.* The Delaware Model did not yet exist, and

332. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

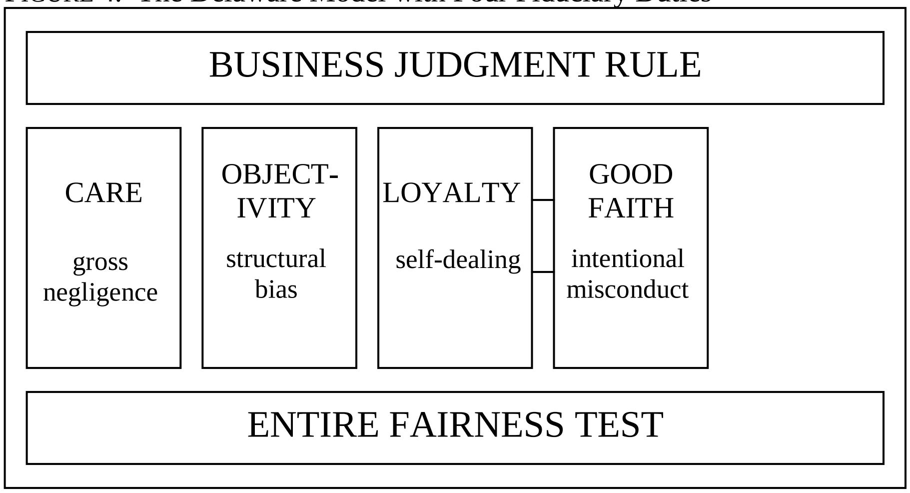
enhanced scrutiny was developed with the Traditional Model in mind. There, a threshold inquiry makes sense: enhanced scrutiny is a tool to determine whether there is a real duty of loyalty issue, in which case the entire fairness test applies, or whether the issues arise under the duty of care, in which case the business judgment rule applies. *Unocal*'s framework can be depicted in this manner:

FIGURE 3. *Unocal*'s Enhanced Scrutiny



In order to fit *Unocal*'s enhanced scrutiny under the Delaware Model, the courts must abandon the notion that it is a threshold inquiry. Viewed as just another filter providing an intermediate level of review, enhanced scrutiny can fit in nicely within the Delaware Model. It could be depicted in the following manner:

FIGURE 4. The Delaware Model with Four Fiduciary Duties



This approach, however, is essentially the same as mine. All that remains to be accounted for is the duty of rationality. It is possible to say that substance lies outside of the unified framework altogether. Because the shareholders must prove waste, however, it seems more accurate to describe rationality as yet another way to rebut the presumption of the business judgment rule. In other words, it is a fifth filter.

In the end, both the Delaware approach and my own can be fit within the Delaware Model. Mine fits a little more neatly, however. Moreover, the Delaware approach fits only to the extent that it is altered to resemble mine.

Taking a closer look at the Delaware Model complicates matters. As many commentators have noted, applying the entire fairness test outside of an interested transaction context is theoretically difficult.[333] Not all director conduct that may constitute a breach of fiduciary duty can be characterized as a discrete transaction. Sometimes, the breach is simply inaction. While it may be simple to classify transactions as fair or unfair, it is more difficult to do so with less discrete actions or inaction.

Such problems, however, are inherent to the unified approach of the Delaware Model. They stem from the fact that the entire fairness test was never designed to be a universal test. It was intended for one particular context: the duty of loyalty, or the second paradigm for enforcement of

333. *See* Allen, Jacobs & Strine, *supra* note 285, at 1302–03; Bainbridge, Lopez & Oklan, *supra* note 12, at 585.

fiduciary duties. Because of the similarity, it may also work reasonably well in the context of the duty of objectivity or the third paradigm for enforcement—provided that the measure of fairness is understood to be reasonableness. Beyond those contexts, however, one must expect an imperfect fit. These imperfections apply to every approach, Delaware's as well as mine.

Despite the inherent limitations of the entire fairness test, my approach can accommodate the Delaware Model as well as any other. All that is necessary is that one understand that fairness can mean different things in different contexts. Consider, for example, the duty of care. A fairness inquiry is a bit complicated: it would be odd to conclude that a grossly negligent decision is entirely fair.[334] Nevertheless, the inquiry can be whether, despite the gross negligence, the result remains fair to the shareholders.[335] This is not too difficult to rationalize. Gross negligence would not necessarily lead to a bad result; it is merely more likely to do so. Despite a deficient process, the end result may be fine—if only by luck. In a sense, the fairness inquiry becomes a proxy for the issue of damages: if the shareholders have been harmed, then the directors will not be able to show fairness, while if the shareholders have not been harmed in any way, then perhaps the directors can.

The fairness inquiry is trickier in cases involving the duty of good faith. The issue becomes whether, despite intentional misconduct, it would be fair not to hold directors liable.[336] It may seem hard to imagine circumstances that satisfy such a test, but there are at least two possibilities. The first situation is where, despite intentional misconduct, there was no harm suffered by the shareholders. For example, despite being malicious, the directors failed and were unable to harm the shareholders. Perhaps directors should be held accountable anyway, but that is not obviously the case. The second situation is where there was no malice. This is possible because good faith covers more than intent to harm; it covers any intentional conduct that the law deems misconduct.[337] For example, it would cover an intentional violation of law or an intent to thwart a shareholder vote. Such behavior is deemed misconduct, but it does not necessarily stem from malice. It may be justifiable or excusable if directors

334. *Cf.* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1140 (Del. Ch. 1995) ("I recognize the force of the claim that a process that is uninformed can never be fair to shareholders.").

335. This was the determination in *Cede & Co. See Cinerama*, 663 A.2d at 1178–80.

336. *See supra* note 96 and accompanying text.

337. *See supra* notes 81–82 and accompanying text.

can show a compelling justification.[338] A compelling justification for an intent to harm may be difficult to imagine, but a compelling justification for conduct that is merely deemed misconduct is easier to imagine.[339] If directors had a compelling justification for their intentional misconduct, then perhaps they can survive the fairness inquiry.

The duty of rationality truly tests the limits of fairness as a universal test. The issue becomes whether an utterly irrational decision that amounts to waste can be considered fair. On the one hand, it is almost impossible to imagine how such a test can be satisfied. On the other hand, it is also very difficult to imagine how the shareholders could establish irrationality or waste in the first place.[340] Especially because the situation is almost entirely hypothetical, there is no need for a per se rule. Directors could be given the opportunity to show fairness—which would translate into something at least as demanding as a compelling justification—even if it is unlikely that they will be able to do so.[341]

In other words, under the Delaware Model, the fairness inquiry is not exactly an application of the entire fairness test or the second paradigm for enforcement. Rather, it is a method to shift the burden of proof onto the directors after the shareholders have rebutted the presumption of the business judgment rule.[342] Understood in this way, it is reasonably workable.

Finally, there is the issue of remedies. Many commentators have criticized the Delaware Model with respect to remedies. They argue that rescission or rescissory damages, which is the usual remedy, is often inappropriate in nonloyalty contexts.[343] That is certainly true. Nevertheless, it is clear in Delaware that the courts have broad discretion in deciding on an appropriate remedy after a fairness inquiry. They may award any equitable or monetary relief, as appropriate.[344] Thus, there is no problem here. Damages can be awarded when appropriate; other cases could be

338. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 660–61 (Del. Ch. 1988).

339. *See, e.g.*, Chesapeake Corp. v. Shore, 771 A.2d 293, 320 (Del. Ch. 2000) (describing delay "to provide more time for deliberations" as a "board action[] that influence[s] the electoral process in [a] legitimate way[]").

340. *See supra* notes 105–07 and accompanying text.

341. Alternatively, the courts could simply acknowledge that the burden is impossible to meet once waste has been established and find the directors liable.

342. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 369 (Del. 1993).

343. *See, e.g.*, Bainbridge, Lopez & Oklan, *supra* note 12, at 587–88.

344. Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983) ("[F]ashion any form of equitable and monetary relief as may be appropriate . . . ."); *quoted in Cede & Co.*, 634 A.2d at 371.

limited to injunctive relief.[345]

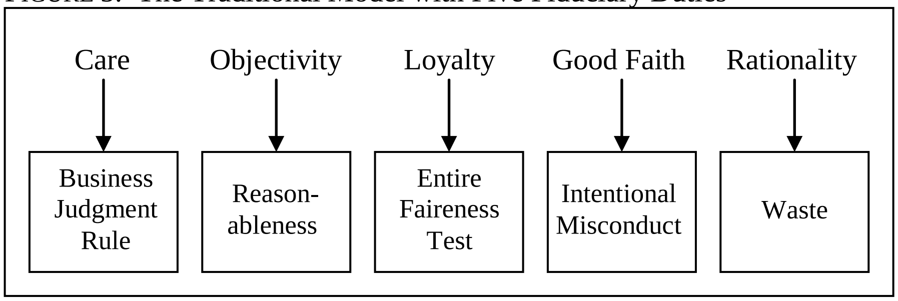
In short, my approach and its five-fiduciary-duty framework can exist within the Delaware Model. Litigation can begin with the presumption of the business judgment rule. The shareholders would have the burden of rebutting that presumption with respect to the five fiduciary duties which are based on the five paradigms for enforcement. Once they have rebutted the presumption of the business judgment rule, the burden would shift to the directors to establish fairness, the exact meaning of which would depend on the circumstances. If the directors fail to do so, the court can award an appropriate remedy.

C. FIVE FIDUCIARY DUTIES UNDER THE TRADITIONAL MODEL

Although my approach works reasonably well within the Delaware Model, it works even better within the Traditional Model. Under the Traditional Model, each of the fiduciary duties would represent one of the five paradigms for enforcement of the one fiduciary duty. There would be five distinct standards of review, with no effort to unify them under a grand theory. Rather, each test would be tailor-made for the circumstances. My approach under the Traditional Model can be pictured as follows:

345. Some commentators seem to believe that *Cede & Co.* relieved the shareholders of any burden to prove damages under the Delaware Model. *See, e.g.*, ALLEN & KRAAKMAN, *supra* note 323, at 261. I am not so sure. *Cede & Co.* merely stated that proof of damages was not necessary for rule rebuttal purposes. *See Cede & Co.*, 634 A.2d at 371 ("To require proof of injury as a component of the proof necessary to rebut the business judgment presumption would be to convert the burden shifting process from a threshold determination of the appropriate standard of review to a dispositive adjudication on the merits."). The court never stated what would have to be proved if the shareholders were to rebut the presumption of the business judgment rule and the directors were to fail to establish fairness. Some have assumed that damages would follow automatically. I do not believe that is a fair reading of the opinion. To the contrary, the court indicated that any damages should be "susceptible to proof" and "appropriate under the circumstances." *Id*. It is hard to see how damages could be appropriate if no injury can be proven.

FIGURE 5. The Traditional Model with Five Fiduciary Duties



Duty of care claims would be reviewed under the first paradigm, or the business judgment rule. The rule would be understood not so much as a presumption, but rather as a standard of review.[346] That standard would be gross negligence.[347] If the shareholders can establish gross negligence, then they would be entitled to damages for any injury they could prove. In many cases, the real issue likely would not be about the existence of injury, but rather about causation. However, that inquiry likely would be affected by the fact that the directors already would have been shown to be not merely negligent, but grossly negligent. If damages cannot be proven, or if directors are protected by an exculpation provision, an equitable remedy would remain available.

Duty of loyalty claims would be reviewed under the second paradigm, or the entire fairness test. The shareholders would have to show only a conflict that rises to the level of self-dealing, and the burden would then shift to the directors to show that the transaction was entirely fair.[348] If the directors cannot establish fairness, then the court would be free to award any appropriate remedy.[349] Presumably, an award of damages would be appropriate only to the extent that an injury could be shown. Otherwise, the remedy would be limited to injunctive relief or, perhaps, nominal damages.

Duty of objectivity claims would be evaluated under the third paradigm, or the reasonableness test. This paradigm is less straightforward

346. It would be possible to preserve a presumption aspect of the business judgment rule: this would be the requirement that, in order to survive a motion to dismiss, the shareholders must not merely allege negligence, but make a satisfactory showing of gross negligence. Even so, it is better classified as a pleading requirement than as a presumption.

347. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

348. *See supra* notes 45–46 and accompanying text.

349. *See supra* note 344 and accompanying text.

than the others.[350] In my opinion, the shareholders should bear the burden of establishing both a situation involving structural bias and an unreasonable decision on the part of directors.[351] If they can do that, they would be entitled to any damages they can prove,[352] or any other appropriate equitable relief.

Duty of good faith claims would be evaluated under the fourth paradigm, or an intent test. The shareholders would bear the heavy burden of establishing intentional misconduct.[353] If they meet this burden, the directors would bear the commensurately heavy burden of establishing a compelling justification.[354] If the directors fail to meet that burden, the shareholders would be entitled to damages for any injury that is established, or some other equitable relief.

Finally, the duty of rationality would be evaluated under the fifth paradigm, or the waste test. The shareholders would bear the extremely heavy burden of establishing that the director's conduct was utterly irrational and amounted to waste.[355] If they can do that, then a damages award would seem to be appropriate to the extent of the waste.

The practical difference between the Traditional Model and the Delaware Model is relatively small. In each case, as in litigation generally, there is a presumption that the defendant is "innocent" and there is a burden on the plaintiff to prove otherwise. If the plaintiff meets this burden then, to some extent or other, the burden shifts to the defendant. Even though the burden technically remains with the shareholders under the Traditional Model, the difference from the Delaware Model is not all that great. This is because the standard is a preponderance of the evidence, or more likely than not.[356] The directors must treat this as if the burden were on themselves in any event.

Yet, despite their similarities, the Traditional Model is superior to the Delaware Model. It is simpler, cleaner, and more sensible. The Delaware Model is awkward and at times seems forced. The Delaware Model might be preferable to the Traditional Model if there were countervailing benefits,

350. *See supra* note 73 and accompanying text.

351. *See* Velasco, *supra* note 19, at 876–79.

352. Unless, of course, directors are exculpated. *See supra* notes 272–76 and accompanying text.

353. *See supra* notes 80–81 and accompanying text.

354. *See supra* notes 89–96 and accompanying text.

355. *See supra* notes 105–06 and accompanying text.

356. *See* BLACK'S LAW DICTIONARY 1301 (9th ed. 2009) (defining "preponderance of the evidence").

but I fail to see any. As a practical matter, the unified test of the Delaware Model does not offer the benefit of simplicity. Where the Traditional Model offers a choice of five standards of review, the Delaware Model offers five filters surrounded by both the business judgment rule and the entire fairness test. If anything, the Delaware Model is more complicated. Moreover, as a theoretical matter, the unified test of the Delaware Model offers few advantages. Any benefit from a unified approach is outweighed by the intellectual awkwardness of trying to fit disparate concepts into a single mold.

I have argued throughout this paper that the question—How many fiduciary duties are there in corporate law?—is not an appropriate question. I also have argued that, if the question must be asked, then the best answer is five. For similar reasons, I believe that the question—How many tests are there for breach of fiduciary duty in corporate law?—is an unnecessary question. As long as the five paradigms for the enforcement of fiduciary duties are preserved, the answer to either question is irrelevant. Nevertheless, practical considerations suggest that, once again, the best answer is five.

Thus, I propose that Delaware courts abandon the unified test of *Cede & Co.* and return to a more traditional model. Each fiduciary duty should be covered by its own standard(s) of review. There is no need to unify these very different tests.

VI. CONCLUSION

The current debate on the number of fiduciary duties in corporate law focuses on whether there should be two or three. Ultimately, it boils down to a question of whether good faith should be considered a separate and independent duty or a part of the duty of loyalty. Everyone agrees that, in substance, there is and should be what may colloquially be considered a duty of good faith. Thus, the debate is almost entirely academic, with little practical significance.

I argue that a better answer would be that there are five fiduciary duties. Of course, my answer is also somewhat academic and is not uniquely correct. In demonstrating why this is so, however, I hope to have shed light on the nature of fiduciary duties. My approach provides a robust framework for the discussion, application, and development of the law of fiduciary duties. In addition, I have shown why the debate matters from a practical standpoint. The urge to simplify creates a risk of oversimplification. Thus, the most promising approach to fiduciary duties is to focus on the paradigms for enforcement.