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Standards of Conduct and Standards of Review in Corporate Law: The Need for Closer Alignment

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Standards of Conduct and Standards of Review in Corporate Law: The Need for Closer Alignment

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I. INTRODUCTION

It is widely recognized that there is a substantial divergence between the “standards of conduct” that are purportedly imposed upon corporate officers and directors by state corporation law and the “standards of review” by which the courts actually assess compliance or noncompliance with those standards of conduct when behavior is challenged.¹ This is particularly apparent in the fiduciary duty of care context, where the prevailing standard of conduct across the various state jurisdictions is the negligence criterion,² while the standard of

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1. See, e.g., Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 *FORDHAM L. REV.* 437 (1993).

2. Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 *COLUM. L. REV.* 1253, 1269 (1999) (“For example, in the area of duty of care the standard of conduct is

review that is actually applied embodies deferential business judgment rule principles,³ essentially providing a much more forgiving gross negligence criterion.

The existence of such a pronounced rift between the articulated standards of conduct and the standards of review that are actually applied by the courts is, at first regard, quite puzzling. It does not appear to make sense regardless of one's personal views concerning the nature of fiduciary duties. One may, for example, favor holding corporate officials to the negligence standard that is widely applied elsewhere in society. Alternatively, strong arguments can be made that the special circumstances of corporate decision-making justify applying a more deferential gross negligence standard.⁴ But what possible justification could there be for the courts to declare that the applicable standard of conduct is the negligence criterion—thereby sending the message that this fairly stringent criterion is not merely an aspirational, legally unenforceable social norm, but is the law—and then to actually apply a more deferential gross negligence criterion whenever that conduct is challenged? Such a divergence between the law as articulated and as actually applied is unusual in our legal system, and is generally condemned when it is recognized. It would seem to be a sure recipe for creating confusion and misunderstanding, both among the persons subject to or protected by the conflicting standards and the courts that must apply those standards.

This divergence in duty of care law between the articulated negligence standard of conduct and the gross negligence standard of review has long mystified scholars, judges, and lawyers, and of course also tormented them in their earlier incarnations as law students.⁵ Many knowledgeable observers have recognized that there are good reasons why the courts should make it rather difficult (though possible) to successfully sue corporate directors and officers for duty of care violations, and why applying a gross negligence standard through the mechanism of a procedure-oriented business judgment rule review may be the most feasible means to accomplish this end.⁶ But, if gross negligence is the appropriate legal standard, what purpose is served by the language in judicial opinions and statutory preambles that an-

'act reasonably' . . .").

3. *Id.* ("[T]he standard of review is often the much looser business judgment standard of rationality.").
4. See, e.g., 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 Gorkum and its Progeny as a Standard of Review Problem*, 96 Nw. U. L. Rev. 449 (2002).
5. See, e.g., Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1743, 1743 n.12 (2001).
6. See, e.g., Allen, Jacobs, and Strine, *supra* note 4.

nounces to corporate directors, officers, shareholders, and judges that the “standard of conduct” imposed upon those corporate officials is higher?

Now, I recognize that a rousing good sermon can be morally uplifting, and may even influence some members of the congregation to behave better. No real harm would be done, and perhaps even some benefits obtained, by including in dicta moral exhortations to corporate officials to aspire to behave more responsibly than the bare legal minimum standards of acceptable conduct. That is, so long as it is made quite clear that these exhortations represent aspirational norms rather than legally enforceable duties. But when such exhortations are presented in the guise of law-like “standards of conduct” obvious potential for confusion and misunderstanding as to the nature of the applicable law is created; the line where the moral exhortations end and the enforceable legal standards begin is blurred. Such a conflation of legal standards and moral aspirations seems unwise in a legal system broadly committed to the basic rule of law principle that persons should be given clear advance notice of the legally enforceable limitations on their conduct, and on the conduct of persons who may serve as their agents. How can this divergence between standards of conduct and standards of review possibly be justified? This Article will examine the arguments that have been made in support of maintaining a divergence between standards of conduct and review, with particular emphasis on their application to the corporate fiduciary duty of care context. I will conclude that these arguments are unconvincing, and that society would be better served if the standards of conduct and review in corporate law were brought into much closer alignment. In my opinion, for each different context in which duty of care issues arise, only a single standard is called for, which both defines the scope of permissible conduct in that context and guides judicial application of that standard. Such a single standard is consistent with our general legal practice. I personally would favor application of the gross negligence/business judgment rule “standard of review” rather than the negligence “standard of conduct,” but my main point is, that regardless of the particular criterion used, a single, clearly articulated standard is preferable to the current conflation of legal standards with moral exhortations.

II. ASSESSING THE ARGUMENT FOR MAINTAINING DIVERGENT STANDARDS FOR THE CORPORATE FIDUCIARY DUTY OF CARE

A. **The Limited Body of Scholarship Justifying Divergent Standards in the Corporate Law Context**

One would expect that such a jurisprudential anomaly in a socially important body of law would have long been subjected to harsh and

sustained criticism, and could only have endured if convincing justification had been offered in rebuttal. It was with some surprise that I discovered that the body of scholarship that argues for maintaining divergent standards is quite limited in quantity and scope, and the branch of that literature that addresses the corporate fiduciary duty of care context is very sparse and relatively unpersuasive.

By far the most significant article in the legal literature that discusses and attempts to justify divergent standards of conduct and review was written in 1983 by Meir Dan-Cohen.⁷ The author explicitly limited his arguments to the criminal law context. The article triggered a comprehensive response by Richard Singer that was published two years later.⁸ In addition, a couple of other writers later applied Dan-Cohen's concepts and arguments in some detail to environmental law⁹ and contract law,¹⁰ respectively. The Dan-Cohen piece is regularly cited for some of its more interesting propositions.¹¹

I am only aware of two articles that have attempted to build upon Dan-Cohen's work in order to assess the desirability of having divergent standards in the corporate fiduciary duty of care context. One of these articles was published in 1984 by David Phillips,¹² and the other in 1993 by Melvin Eisenberg.¹³ There are a number of other articles that briefly note the existence of this divergence in the corporate fiduciary duty of care context.¹⁴ A few of these articles make reference to the Dan-Cohen and/or Eisenberg articles noted above as providing some intellectual justification for maintaining this divergence.¹⁵ However, the Phillips and Eisenberg pieces are the only efforts of which I am aware that go beyond merely recognizing the existence of this divergence in the corporate law context, or simply noting that other writers have offered a justification for its persistence, and at-

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7. Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984).
 8. Richard Singer, *On Classism and Dissonance in the Criminal Law: A Reply to Professor Meir Dan-Cohen*, 77 J. CRIM. L. & CRIMINOLOGY 69 (1986).
 9. Christopher H. Schroeder, *Rights Against Risks*, 86 COLUM. L. REV. 495 (1986).
 10. Emily L. Sherwin, *Law and Equity in Contract Enforcement*, 50 MD. L. REV. 253 (1991).
 11. A Lexis search of "law reviews" conducted on March 2, 2003 using the search phrase "Dan-Cohen and decision rules" identified 161 citations.
 12. David M. Phillips, *Principles of Corporate Governance: A Critique of Part IV*, 52 GEO. WASH. L. REV. 653 (1984) (appearing in the Symposium, *American Law Institute's Corporate Governance Project: in the Duty of Care* section).
 13. Eisenberg, *supra* note 1.
 14. See, e.g., Allen, Jacobs & Strine, *supra* note 4, at 451; Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1643 (2001); D. Gordon Smith, *A Proposal to Eliminate Director Standards from the Model Business Corporation Act*, 67 U. CIN. L. REV. 1201, 1203 (1999).
 15. Allen, Jacobs, & Strine, *supra* note 4, at 451-58; Smith, *supra* note 14, at 1202-05.

tempt to examine and assess the justifications for maintaining a divergence in that context.

Neither of these two articles provides anything approaching a complete analysis of the divergence question in corporate law. The Phillips article addresses a broad range of corporate governance topics that were raised by the American Law Institute's Corporate Governance Project, and devotes only two pages to the normative issues raised by the divergence of standards of conduct and review.¹⁶ Eisenberg's 1993 article does focus exclusively upon the divergence phenomena. However, he places primary emphasis on describing the extent to which the divergence between standards of conduct and review permeate virtually all of corporate law, and only devotes a relatively short section of his article to explaining and justifying this pervasive divergence.¹⁷

Eisenberg's normative arguments are essentially a summary restatement and uncritical extension of some of the arguments originally presented by Dan-Cohen who addressed these questions in much greater depth and breadth. However, as previously noted Dan-Cohen's analysis of the relationship between standards of conduct and review was expressly limited by the author to criminal law questions.¹⁸ The analysis primarily considered the particular situations where judges apply duress, excuse, and other mitigating doctrines that favor the accused person in instances where the availability of those mitigating doctrines is not apparent from the language of the applicable standards of conduct.¹⁹ As I will discuss below, it is very problematic whether Dan-Cohen's arguments, whatever their merits in the criminal law context for which they were advanced, have any application at all in the corporate law context.

I will proceed by first examining in some detail Dan-Cohen's seminal arguments in favor of maintaining the divergence between standards of conduct and review in the criminal law context. I will also draw upon the comprehensive response to these arguments offered by Richard Singer. I will then turn to consideration of David Phillips' normative assessment of divergent standards in the fiduciary duty of care context, and to Melvin Eisenberg's attempt to marshal and extend Dan-Cohen's arguments to justify maintaining such a divergence in that context.

16. Phillips, *supra* note 12, at 667-668.

17. Eisenberg, *supra* note 1, at 461-67 (article in Section VI entitled "Why Standards of Conduct and Standards of Review Diverge in Corporate Law").

18. Dan-Cohen, *supra* note 7, at 626. ("I limit both my claims and my illustrations to the criminal law. . . . [if the analysis has any application to other fields, this] will have been an incidental benefit rather than the direct purpose of my enterprise.")

19. *Id.* at 636-664.

Before I begin to address these writers' arguments let me briefly summarize my conclusions. First, I am in broad agreement with Richard Singer that Dan-Cohen's case for maintaining divergent standards in the criminal law area, while comprehensive, interesting and having some intuitive appeal, is ultimately unconvincing even in the restricted context in which it is presented. Second, I conclude that even if one accepts Dan-Cohen's endorsement of divergent standards in certain specific criminal law areas when there also exist certain restrictive conditions regarding limited public access to standard of review criteria, those arguments are very context-specific and do not generalize well over to the corporate fiduciary duty of care context, where not only the interests of corporate officials, but also the competing interests of other persons such as corporate shareholders, are implicated by having divergent standards. The Phillips article is in full accord with my conclusions, and while Eisenberg disagrees with me, his arguments are incomplete and unpersuasive.

My ultimate conclusion is that the case for maintaining divergent standards of conduct and standards of review in the corporate fiduciary duty of care context has not been made, and that courts and legislatures should therefore no longer endorse this divergence and should strive to bring the standards of conduct and review into much closer alignment.

B. The Dan-Cohen Arguments and the Singer Response

1. *Bentham's Recognition of the Distinction Between Conduct Rules and Decision Rules*

Dan-Cohen begins his analysis by noting that recognition of the distinction between standards of conduct and standards of review (which he refers to as "conduct rules"²⁰ and "decision rules,"²¹ respectively, usages that I will respect in the following discussion of his article) can perhaps be traced as far back in history as the Talmud,²² and certainly at least as far back as Jeremy Bentham. To support this claim he presents two quotes by Bentham in which that writer first contrasts the particular conduct rule "Let no man steal" with the corresponding decision rule "Let the judge cause whoever is convicted of stealing to be hanged."²³ He then states that "by *implication*, and that a necessary one, the [latter] punitive [decision rule] does involve

20. *Id.* at 627.

21. *Id.*

22. *Id.* at 626 n.1.

23. *Id.* at 626 (quoting J. BENTHAM, A FRAGMENT ON GOVERNMENT AND AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION 430 (W. Harrison ed., 1948)).

and include the import of the simply imperative law [the former conduct rule] to which it is appended.”²⁴

Let me first note that while these quotes demonstrate that Bentham recognizes the distinction between conduct and decision rules, the contrast he depicts is not really an instance of divergence. The two rules as stated are entirely consistent with one another as to the nature of the prohibited conduct. It is clear that Bentham understood—and doubtless endorsed as well—the rather obvious point that those persons that are charged with enforcing a conduct rule that is stated in broad, general language are in need of a more detailed articulation of that rule, particularly with regard to the penalties that are to be imposed for violations, than are the persons subject to that conduct rule who for most purposes need only to know what conduct is prohibited. However, I do not read Bentham as going beyond endorsing the articulation of consistent conduct and decision rules at different levels of generality for different purposes to also endorse the idea of having a substantive divergence between the conduct and decision rules.

I understand Bentham to be merely recognizing that detailed decision rules are generally associated with the existence of consistent but more broadly stated conduct rules, and that therefore, a single rule expressed at different levels of generality as needed can usually suffice, both to guide public behavior and official decisions. Dan-Cohen, however, understands Bentham, by his use of the “necessary implication” phrase quoted above, to be claiming much more than this; that as a matter of pure logical entailment conduct rules and decision rules must necessarily be entirely consistent.²⁵ He then proceeds to criticize this view, that he attributes to Bentham, as an incorrect “reductionist position.”²⁶

Dan-Cohen argues that one who takes this reductionist stance and thereby concludes that conduct rules are necessarily and completely derived from their associated decision rules “obscures ‘the specific character of law as a means of social control,’”²⁷ which may call for incorporating other considerations into the design of conduct rules beyond the content of their associated decision rules. Those who draw reductionist inferences in the opposite direction, so to speak, by regarding decision rules as necessarily and completely derived from their associated conduct rules, are also said to be mistaken in that

24. Dan-Cohen, *supra* note 7, at 626.

25. *Id.* at 627 (“Bentham’s account of the distinction, however, supposes too simple a relation between the two kinds of rules. If we are to generalize from Bentham’s example, we must conclude that the laws addressed to officials . . . necessarily imply the laws addressed to the general public . . . [this is an incorrect] reductionist position . . .”).

26. *Id.*

27. *Id.* at 627.

they ignore the fact that the conduct rules by themselves often do not provide sanctions for their violations, nor even specifically address the role of the judge in enforcing those conduct rules.²⁸

Dan-Cohen's critique of a rather strained interpretation of Bentham that seemingly few would embrace is somewhat opaque as to its purpose in furthering his normative claims. As best as I can follow his argument, Dan-Cohen's main point is that regarding conduct rules as merely being logically entailed and abbreviated statements of the more detailed decision rules overlooks the additional roles those standards of conduct can play, either as moral exhortations intended to strengthen desirable, extra-legal social norms, or by providing subject persons with a "cushion of safety" by describing the prohibited conduct more broadly than the actually enforced limitations, which together may call for having the conduct rules diverge from the decision rules in a substantive manner. His second point is apparently the more obvious one: that without additional guidance from other sources, one cannot logically derive the more detailed decision rules from conduct rules, nor even establish the basic principle that judges are to enforce conduct rules.

I certainly concur with Dan-Cohen's criticism of the "necessary implication" interpretation of Bentham's statements, though as I have noted I do not interpret them in that manner. However, and more importantly, his entire discussion here is somewhat beside the point in that it fails to squarely address the real question at issue: granted that it is *possible* to have a divergence between conduct rules and decision rules, is it *desirable*?

2. *The Prerequisite of Acoustic Separation*

Dan-Cohen eventually addresses this question in some detail later in his article, but in an intervening and important discussion he recognizes as a threshold matter: that the advantages he will later argue can result from having divergent conduct and decision rules are dependent on there being an "acoustic separation"²⁹ between those persons subject to the conduct rules and the officials who apply the decision rules.³⁰ In other words, it is crucial that the persons subject to the conduct rules are not made aware that their conduct, if challenged, will in fact be judged by different decision rules. He concedes that if those persons who are subject to the conduct rules do somehow become aware of the existence and scope of the different decision rules that will be applied, they are likely to conform their conduct to the legally enforced decision rules rather than to the unenforced conduct

28. *Id.* at 628.

29. *Id.* at 630.

30. *Id.*

rules, and the norm-shaping and other advantages of having divergent rules will be lost.³¹

This recognition that the argument for having different conduct and decision rules is predicated upon there being an effective “acoustic separation” between those persons subject to the conduct rules and the officials that will apply the decision rules is a very significant concession by Dan-Cohen. It limits his defense of divergent rules to those unusual circumstances where the persons subject to a conduct rule are either unaware of the different decision rule, because of vagueness in the articulation of the conduct rule or for other reasons, or if aware of it, then unable to understand the different decision rule because the decision rule is communicated to officials through some form of “selective transmission,”³² such as through the vehicle of a specialized, technical vocabulary, that is inaccessible to the persons subject to the conduct rule.³³

In situations where there exists such “acoustic separation” Dan-Cohen argues that a divergence between conduct rules and decision rules might better enable the legal system to simultaneously achieve the two competing goals of, first, effecting deterrence of criminal conduct and, second, providing leniency where appropriate due to special circumstances, than would having a uniform rule.³⁴ His major illustration offered in support of this claim is the criminal defense excuse of duress. In his view, a criminal law conduct rule which does not call attention to the potential availability of a duress defense under certain circumstances will better deter criminal conduct than would a conduct rule that recognized the duress defense, since the latter formulation might encourage a Holmesian “bad man”³⁵ to steer his be-

31. *Id.* at 632 (“[T]he possibility that conduct or decision rules may have such unintended side effects creates the potential for conflict between decision rules and conduct rules in the absence of acoustic separation. A decision rule conflicts with a conduct rule if the decision rule conveys, as a side effect, a normative message that opposes or detracts from the power of the conduct rule. Conversely, a conduct rule conflicts with a decision rule when the messages it sends decision-makers contradict the decision rule. Such conflicting messages are impossible under conditions of acoustic separation . . . [under those circumstances] neither group is in danger of receiving conflicting messages addressed to the other.”)

32. *Id.* at 635.

33. *Id.* at 631-634.

34. *Id.* at 633 (“The law faces a hopeless trade-off between the competing values of deterrence and compassion [or fairness]; whichever way it resolves the question of duress, it must sacrifice one value to the other. The impasse dissolves, however, if we analyze the problem in terms of the distinction between conduct rules and decision rules When we do so, it becomes obvious that the policies advanced by the [duress] defense would lead to its use as a decision rule Just as obviously, no comparable rule would be included among the conduct rules”).

35. See OLIVER WENDELL HOLMES, *The Path of the Law*, in COLLECTED LEGAL PAPERS 167, 169-79 (1920).

havior closer to, or even across, the criminal conduct line. However, a judge in deciding whether to punish an instance of behavior that violated a criminal conduct rule would obviously want, in the interest of fairness and mercy, to be able to consider the possibility of more lenient treatment due to the presence of factors sufficient to justify a complete or partial duress defense, so that the elements of the duress defense should be included in the decision rule.³⁶

Here we have reached the core of the Dan-Cohen argument in favor of having divergent rules: when it is possible to “acoustically separate” the messages sent to different classes of persons, so as to avoid public confusion as to the contours of the applicable rule, it may be preferable to provide the general public with a relatively strict conduct rule, so as to discourage persons from walking closer to the criminal conduct line in the hope that, if accused, they will be able to prevail by relying upon various situation-specific excuses and other defenses, while simultaneously and covertly providing judges with a more flexible decision rule that will allow them to exercise leniency when it is called for.

Even if one concedes that such a regime of divergent rules under conditions of acoustic separation would have certain social benefits, in that it would simultaneously promote deterrence and yet provide for leniency where needed, there is obviously a real question as to whether such a covert and paternalistic approach is a legitimate means of achieving these objectives. Dan-Cohen clearly recognizes this problem and addresses the legitimacy issue in some detail in the latter portion of his article.³⁷ I will address these arguments below, but I would like to first explain why I believe that the questions of the merits of these arguments as applied to the corporate law context are moot.

These questions are mooted because the threshold prerequisite of effective acoustic separation that Dan-Cohen concedes is necessary before there is any possibility that a divergence of standards might be justified is unlikely to ever be present in the corporate law context. He recognizes that complete acoustic separation is unlikely to ever occur,³⁸ but asserts that various mechanisms of “selective transmission,” such as the use of a specialized technical vocabulary not accessible to the general public to communicate decision rules, may result in significant “partial acoustic separation” of divergent messages in some instances in the criminal law context.³⁹ However, he does not attempt to empirically demonstrate precisely where in our criminal law framework there exists, due to selective transmission

36. Dan-Cohen, *supra* note 7, at 632-33.

37. *Id.* at 665-77.

38. *Id.* at 631.

39. *Id.* at 634-35.

mechanisms or otherwise, a significant enough degree of acoustical separation with regard to particular conduct and decision rules to create the possibility of maintaining a divergence between them in order to achieve his deterrence-plus-leniency objectives. *A fortiori*, he does not make any such empirical claims with regard to any corporate law rules.

One would think that a high degree of acoustical separation would be a rather rare occurrence. Even in the "street crime" criminal law context, where the linguistic gulf between potential criminals and judges is relatively large, indirect social mechanisms operate to communicate the essential content of decision rules to potential criminals in a language they can understand. In the corporate fiduciary duty law context significant acoustical separation would seem to be rare indeed, if not non-existent. Senior corporate officials have excellent access to the detailed text of the applicable decision rules, as well as the training, background and, if necessary, legal advice to effectively understand the import of those decision rules. This high degree of access and capability to understand decision rules also exists, albeit to a somewhat lesser extent in some instances, for corporate shareholders.

In addition, it would appear that any significant degree of acoustical separation with regard to any conduct rule/decision rule pair would tend to lessen over time because the subject persons would learn more about the decision rules from their experiences with judicial enforcement. By comparing the judicial rulings with their *ex ante* conduct rule-based expectations, and noting the regular and systematic inconsistencies between them, they will be put on notice that some hidden decision criterion is being applied by the decision-makers and given clues as to the contours of the criterion.⁴⁰ As any parent knows only all too well, even when children are given broad conduct rules of an absolute "do your homework on time," "be home by 8:00 p.m.," and so forth, they nevertheless very quickly learn to infer the true contours of the decision rules, and then conform their conduct to those decision rules rather than to the formally declared conduct rules. Such children, when they grow up to run corporations, get much better at ferreting out those decision rules, while remaining adept at inferring from consequences what they do not hear directly.

3. *The Argument for Legitimacy*

Let me now turn to the arguments offered by Dan-Cohen in the closing portion of his article⁴¹ wherein he defends the legitimacy of having divergent conduct and decision rules. He limits his defense to

40. Singer in his response to Dan-Cohen notes this possibility as well. Singer, *supra* note 8, at 86.

41. Dan-Cohen, *supra* note 7, at 665-77.

circumstances where there is a sufficient degree of acoustical separation to make this a potential approach for simultaneously achieving deterrence while preserving judicial flexibility to provide leniency.⁴²

Dan-Cohen begins his legitimacy analysis from the uncompromising stance that the only divergences between conduct and decision rules that could conceivably be legitimate are those where the decision rule is more lenient in favor of the accused than is the associated conduct rule. A decision rule that would impose a punishment for conduct not prohibited by the associated conduct rule is one that inflicts "hidden punishments" and thus is "clearly illegitimate."⁴³

I certainly agree that the comparative leniency of decision rules that differ from their associated conduct rules is a necessary condition for their legitimacy. However, this position suggests a symmetrical argument. A decision rule that is more lenient than the associated conduct rule also imposes hidden punishments in a sense, this time upon the criminal victim and other members of the general public who reasonably expect that accused persons will be held to the standards of the articulated conduct rule rather than only to the standards of a hidden and more lenient decision rule. Dan-Cohen does not address this potential problem,⁴⁴ and my surmise is that he regarded this as invoking hypothetical consequences too abstract and diffuse to merit meaningful consideration in a legitimacy inquiry. I believe, however, that these consequences are more significant than Dan-Cohen recognizes, and Richard Singer is in full accord on this point.⁴⁵

42. 42. Dan-Cohen in at least two points in his article suggests that he is merely explaining the divergence of conduct and decision rules, not endorsing it. *Id.* at 636 ("[Application of this model here is not meant] to endorse the law's attempt to segregate its normative messages through acoustic separation."); *Id.* at 677 ("[The legitimacy of divergent standards] is ultimately a matter of substantive moral choice that the analysis presented here can help clarify but cannot resolve."). However, I read the overall thrust of his article as supporting divergence, at least under limited circumstances. In accord is Richard Singer. *See* Singer, *supra* note 8, at 73 ("In my own reading, however, [Dan-Cohen] supports both selective transmission and acoustic separation, primarily as a means to deter persons from criminal and even near criminal acts.").

43. Dan-Cohen, *supra* note 7, at 665 n.10.

44. *Id.* at 671 ("[W]hen decision rules are more lenient than conduct rules . . . no one is likely to . . . complain of frustrated expectations.").

45. Singer takes strong exception to Dan-Cohen's claim that no one would be prejudiced by criminal law decision rules that are more lenient than the associated conduct rules:

This, however, is surely wrong. The most obvious complainant will be the victim. While the victim cannot be said to have 'relied' upon the conduct rule, he will surely be annoyed, or worse, when he learns there is no penalty, or a lesser penalty, attached to the violation of the conduct rule than he was led to believe. Moreover, those who abstained from those acts which the decision rules make legal may also complain that they would have engaged in equally legal behavior . . . had they known. Fi-

Even if one regards decision rules that are more lenient than their associated conduct rules as potentially legitimate in the criminal law context, as I will discuss below in connection with Melvin Eisenberg's article, if one attempts to justify also having divergent conduct and decision rules in the civil suit context of corporate fiduciary duty law, one simply must confront the fact that leniency for corporate officials with regard to their lack of compliance with duty of care conduct rules necessarily imposes equivalent "hidden punishments" upon an identifiable class of corporate shareholders. It punishes in the very meaningful and concrete sense of abridging their formally articulated principle-agent duty of care rights. One can only speculate as to whether Dan-Cohen himself would regard this difference in context as fatal to efforts to broaden the scope of his legitimacy defense to the corporate law context, but his strong condemnation of the idea of hidden punishments suggests that he may for this reason regard his defense of divergent rules as strictly limited to the criminal law context.

In his response to Dan-Cohen's article, Richard Singer notes another problematic feature of having decision rules that are more lenient than conduct rules: that those members of the public that are aware of the decision rules—and there will always be such people in the absence of complete acoustical separation—will be able to take unfair advantage of this awareness.⁴⁶ Another troubling concern is the reality that professional criminals are more likely to become aware of and manipulate to their advantage the true and more lenient decision rules than are the more law-abiding members of the public.⁴⁷

Let us accept for the moment Dan-Cohen's premise that divergences between conduct rules and decision rules might possibly be justified under some circumstances where the decision rules are more lenient to the accused person than are the conduct rules. He addresses in some detail the concern that the ideal of the "rule of law" requires a degree of openness and candor that simply precludes having such divergences.⁴⁸ He considers four arguments that are commonly invoked in favor of understanding the rule of law to require public and clearly stated pronouncements, and concludes that none of

nally . . . the offender who is not afforded the leniency will also complain.
(Footnotes omitted)

Singer, *supra* note 8, at 99.

46. *Id.* at 85.

47. *Id.* at 86-87.

48. Dan-Cohen, *supra* note 7, at 667 ("[T]he ideal of the rule of law expresses an ethos of law as an area of public life particularly committed to the values of openness and candor. Central to the rule of law is the requirement that the laws be clearly stated and publicly proclaimed. The alarm likely to follow the realization that selective transmission may circumvent these requirements accordingly seems well founded.").

these arguments necessarily preclude having a divergence between conduct and decision rules.⁴⁹

He first recognizes that the rule of law serves to limit the possibility for arbitrary actions by government officials, but reasons that a divergence between conduct and decision rules does not undercut these limitations because the effectiveness of decision rules to serve this purpose “does not depend on broad dissemination or easy accessibility of those rules to the general public.”⁵⁰ However, the rather obvious response is that this may not be the case—that a reduction in the visibility of decision rules might well serve to reduce the accountability of legal decision-makers to the public. Dan-Cohen simply does not address this objection.

Second, he notes that conformity to the openness premise of the rule of law is often claimed to generally increase the efficacy of the law in achieving whatever goals are sought through legal means.⁵¹ His response to this is to assert that selective transmission of decision rules to a limited audience and their concealment from public view, may in fact “best serve the purposes of the law” in instances where publicity and clarity “impede its usefulness.”⁵² He is apparently referring again to the norm-bolstering/cushion of safety/judicial flexibility advantages that he believes may result from divergence, and which may upon occasion outweigh the costs of departing from rule of law principles. When his claim is stated in these very general terms, I simply find it impossible to evaluate.

Third, he responds to a commonly offered utilitarian justification in defense of the publicity and clarity of the rule of law that calls for a complete dissemination of all decision rules to the public.⁵³ He finds the sweeping proposition unfounded, reasoning that under some circumstances, it is possible that for an individual the greater publicity and clarity of the law “would indeed serve the individual’s goals but diminish rather than promote social utility.”⁵⁴ Unfortunately, absent a definition of some metric by which to assess the overall utilitarian consequences of various degrees of publicity and clarity of particular laws it is also impossible to evaluate this claim. Perhaps this is an area where he could have again turned to Bentham—the original utilitarian!—for some assistance!

Finally, Dan-Cohen addresses the argument that the rule of law is necessary to provide the predictability and security necessary for peo-

49. *Id.* at 667-73.

50. *Id.* at 668.

51. *Id.*

52. *Id.* at 669.

53. *Id.* at 669-70.

54. *Id.* at 670.

ple to live autonomously and plan their affairs effectively.⁵⁵ After some extended discussion of this argument he concludes that divergence between conduct rules and decision rules is not a problem in this regard because conduct rules are all that need to be publicized to achieve these goals, and public knowledge of the decision rules is not necessary.⁵⁶ However, the argument that conduct rules more restrictive than their associated decision rules do not limit personal autonomy is unconvincing.⁵⁷ He again concedes here that his conclusion is only valid when the decision rules are more lenient than their associated conduct rules,⁵⁸ which, as noted above, sharply undercuts efforts to generalize his normative arguments to the corporate law civil suit context.

As my comments above indicate, I find incomplete and problematic his effort to accommodate a divergence between conduct and decision rules with the openness, clarity and autonomy values implicit in a commitment to the rule of law.⁵⁹ Even if one finds these arguments convincing, it is important to note that Dan-Cohen concludes this part of his analysis with the very modest claim that while he has now demonstrated that the traditional "rule of law" openness and clarity concerns do not alone render a divergence between conduct and decision rules illegitimate, he has not yet affirmatively justified engaging in this practice.⁶⁰

In the last portion of his article Dan-Cohen presents his final, affirmative justification for divergence between conduct and decision rules. He articulates a broad and open-ended rationale that calls for situating the legitimacy inquiry within a larger and more realistic context that gives proper weight to the "brutality" implicit in criminal punishment.⁶¹ In doing so, he rejects being unduly fastidious about the legal means utilized because, as he states, just as is often the case in political affairs, sometimes the only way to use the law to achieve a noble end involves accepting the burden of "dirty hands" that results from the use of surreptitious and distasteful but necessary measures.⁶² From this perspective, while partially sacrificing the rule of law values of publicity and honesty may result from the maintenance

55. *Id.* at 670-71.

56. *Id.* at 670-73.

57. Singer, *supra* note 8, at 98 ("For those for whom autonomy is a precious right, even when that autonomy comes close to criminality, the bark-bite philosophy espoused by Professor Dan-Cohen is on shaky ground.")

58. Dan-Cohen, *supra* note 7, at 671 ("The need for security of individual expectations is not a great obstacle to the use of selective transmission when decision rules are more lenient than conduct rules lead people to expect.")

59. Singer is in full accord. Singer, *supra* note 8, at 100. ("In summary, the argument for acoustical separation . . . fails on both utilitarian and normative grounds.")

60. Dan-Cohen, *supra* note 7, at 673.

61. *Id.* at 674.

62. *Id.* at 676-77.

of divergent conduct and decision rules in a particular instance, the sacrifice may be justified when needed to prevent human suffering, whether in the form of preventable crimes or excessive criminal punishment.⁶³

This would be a difficult argument to evaluate even with regard to a very specific conduct rule/decision rule pair, let alone in general terms. I will not attempt to respond directly, but will simply point out that much of its force stems from the empathy one naturally feels for those burdened by unnecessary criminal victimization due to insufficient deterrence of crime, or for those burdened by excessive criminal punishment due to limited judicial flexibility that impedes granting proper leniency. Both of which are absent in the civil suit corporate law context.

In overall summary, Dan-Cohen's normative objective in his article is actually quite carefully limited. He attempts to only justify the divergence between conduct rules and decision rules in certain special situations arising in the criminal law context, and only under circumstances of significant acoustical separation between the different classes of persons to whom the conduct and decision rules are selectively communicated, and even then, only where the decision rules are more lenient for the subject persons than are the conduct rules. As noted in the Introduction, my overall conclusion is that even within this limited context Dan-Cohen has not successfully made the case for maintaining a divergence between conduct and decision rules.

If, however, one disagrees with both Richard Singer and myself and believes that Dan-Cohen has presented a convincing argument justifying a divergence between conduct and decision rules under the narrowly circumscribed conditions he sets out to address, then the question is posed as to whether his arguments can be extended to justify a comparable divergence between the standards of conduct and standards of review in the corporate fiduciary of care context. David Phillips concludes that they cannot, but Melvin Eisenberg attempts to make the case that these arguments do successfully apply in this context. To these articles I will now turn.

C. The Phillips and Eisenberg Arguments Regarding Whether Divergent Standards Are Justified in the Corporate Fiduciary Duty of Care Context

As noted above in the Introduction, the Richard Phillips article addresses a number of questions raised by the American Law Institute's 1984 Principles of Corporate Governance document⁶⁴ and only devotes

63. *Id.* at 677.

64. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Tentative Draft No. 3, 1984) [hereinafter 1984 Principles].

a short discussion to duty of care issues. In that discussion he notes a discrepancy between the Section 4.01 formulation of the fiduciary duty of care proposed by the 1984 Principles and the business judgment rule jurisprudence, recognizing that this discrepancy can be characterized as a divergent conduct rule/decision rule pair under Dan-Cohen's conceptual framework.⁶⁵ He initially appears to embrace in very general terms Dan-Cohen's argument justifying divergence, concluding that while divergence "may indeed be appropriate in certain contexts to accomplish equity or to foster other values and policies,"⁶⁶ such divergence should be characterized by decision rules that are more lenient regarding the behavior of the persons subject to them than are their associated decision rules.⁶⁷ However, when he applies those arguments to the corporate duty of care context he very quickly concludes that "one would be hard pressed to defend" maintaining divergence in that context because of the unlikely prospect of there being the significant acoustical separation necessary to achieve the aims sought by Dan-Cohen.⁶⁸ In his view, the only persons likely to be significantly affected by such a divergence would be some fraction of the less sophisticated "noninstitutional shareholders," who might be thereby misled as to the extent of director liability for duty of care violations.⁶⁹ He concludes that divergence in this area of law is undesirable and serves to "undermine the utility of the duty-of-care doctrine."⁷⁰

Melvin Eisenberg's 1993 article is devoted primarily to describing in some detail the pervasiveness of divergence between standards of conduct and review in corporate law. He also includes a section addressing, to a limited extent, the normative questions raised by the divergence, although in a much more abbreviated fashion than the more descriptive portions of the article.⁷¹

Essentially, Eisenberg's approach to these normative issues is to briefly summarize a few of the justification arguments made by Dan-Cohen in his article, and then to broadly and summarily generalize those arguments to the corporate law context. He initially draws upon Dan-Cohen's discussion of Bentham's writings, once again to make the simple point that it is logically possible to have a divergence between standards of conduct and standards of review.⁷² He then introduces Dan-Cohen's concept of acoustic separation, noting as did Dan-Cohen

65. Phillips, *supra* note 12, at 667.

66. *Id.*

67. *Id.*

68. *Id.* at 667-68.

69. *Id.* at 668.

70. *Id.*

71. Eisenberg, *supra* note 1, at 461-67.

72. *Id.* at 462.

that conditions of partial acoustic separation create the opportunity to achieve important social goals through use of divergent standards.⁷³

Eisenberg then turns to the question of whether standards of conduct can be regarded as meaningful legal rules when they differ from their associated standards of review. Recall that Dan Cohen's position here was that conduct rules that differ from decision rules are nevertheless potentially significant because of their norm-shaping effects, and because of the "cushion of safety" that they provide for the public by imposing broader limitations on conduct than do their associated decision rules. Eisenberg, however, goes much further than this limited claim made by Dan-Cohen and flatly declares that "standards of conduct have a real bite."⁷⁴ Apparently this is so without regard to the degree of acoustical separation that may be present, because in Eisenberg's opinion many corporate directors and officers will nevertheless conform their behavior to the standards of conduct, rather than to the standards of review. Why will they do this? Eisenberg offers two complementary explanations.

First, Eisenberg explains that many corporate directors and officers will do so out of prudence, because "a director or officer who relies only on a standard of review that is less demanding than the parallel standard of conduct is at risk that the standard of review will be deemed inapplicable and liability will be imposed under the standard of conduct."⁷⁵ I believe that Eisenberg is here mistaken.

A director who conforms to the standard of conduct because he perceives that if his conduct is challenged the standard of conduct rather than the "normal" standard of review criteria may be applied is still conforming his conduct to the standard of review as he perceives it to be, rather than to the standard of conduct itself. He is simply recognizing that the standard of review is an uncertain standard that may under some circumstances be applied so as to impose the tougher standard of conduct criteria rather than the "usual" and more forgiving standard of review criteria. Put another way, it is not that standards of conduct have a real "bite," but rather that uncertain and variable standards of review are likely to result in behavior that skirts their expected outer limits, which may coincidentally be the limits of the standard of conduct. The point is that it is still the standard of review that is compelling conformity, not the standard of conduct.

Eisenberg's second explanation for claiming that standards of conduct are meaningful legal rules is that they "also serve as a foundation for private standards of conduct."⁷⁶ According to Eisenberg the legal advice given to corporate clients, and the private codes of conduct

73. *Id.* at 462-463.

74. *Id.* at 464.

75. *Id.*

76. *Id.*

adopted by corporations and circulated to their employees, are generally based upon the standards of conduct and not the standards of review.⁷⁷ Eisenberg simply asserts this to be the case without offering any empirical support, and without explaining why one would expect this to be so in the absence of significant acoustical separation that worked to deny lawyers and corporate code-drafters access to the standards of review. Nor does he offer a rationale as to why corporate decision-makers would then choose to conform their conduct to these aspirational codes or to this excessively conservative legal advice if they were aware of the actual decision rules. If these claims are true it would have the important consequence of justifying divergence even absent significant acoustical separation. Such counter-intuitive claims must be demonstrated rather than merely asserted.

For the sake of argument, let us accept for the moment Eisenberg's claim that standards of conduct that diverge from their associated standards of review may meaningfully affect behavior, even in the absence of significant acoustical separation. The important normative question that Dan-Cohen wrestled with extensively is thus again squarely presented: is it desirable that we have this divergence? What social benefits are thereby obtained, what social costs are imposed, and is this approach a legitimate means of obtaining those net social benefits?

Unfortunately, Eisenberg's normative case is far less developed than was Dan-Cohen's, and simply overlooks the major issues while addressing more tangential concerns. For example, he devotes considerable discussion to defending the claim that actors who are engaged in primary conduct are in need of relatively simple and easily communicated standards of conduct, while the standards of review are directed primarily at judges and therefore can be formulated in a much more complex and detailed manner.⁷⁸ This is certainly true, but it only provides justification for having consistent standards of conduct and standards of review expressed at different levels of generality to different publics, not for having a divergence between the substantive criteria imposed. He also notes in this discussion that articulations of the standards to different publics at different degrees of complexity may create a partial acoustic separation which will magnify the impact of divergent standards, but again does not attempt to justify in the first instance imposing such impacts.⁷⁹

The closest Eisenberg ever comes to offering a normative justification for divergence is when he states that "we are now brought to the question, what accounts for the pervasive divergence."⁸⁰ Eisenberg

77. *Id.*

78. *Id.* at 466.

79. *Id.* at 467.

80. *Id.* at 464.

then answers his own question in the duty of care context by stating that "the law wants to send directors and officers a two-part message[:]"⁸¹ that corporate officials should act with due care, but that they will be held liable only if they behave in a grossly negligent manner. Eisenberg's "answer" merely restates the existence of a divergence without either explaining or justifying its presence.

Eisenberg fails to address the central legitimacy and the extent of acoustical separation questions that need to be faced in defending the use of divergent standards of conduct and review in the corporate law context. In all fairness, providing a normative defense of divergent standards was apparently not the primary purpose of his article, which focuses much more on simply describing the pervasiveness of the practice in corporate law. In addition, the portion of his article that contains what little there is by way of a normative discussion was given the explanatory oriented title "Why Standards of Conduct and Standards of Review Diverge in Corporate Law," and not a more justification-oriented title such as: "Is it a Good Idea that the Standards of Conduct and Review Diverge in Corporate Law?" Nevertheless, given that Eisenberg is implicitly joining the normative controversy through his extensive and approving citation of the Dan-Cohen normative arguments, it would seem appropriate for him to have gone a bit further and taken a position on each of Dan-Cohen's major normative claims, particularly since as I have attempted to demonstrate they are highly contestable claims. He at the least should have devoted some effort to address the difficult additional issues raised when one attempts to apply the Dan-Cohen criminal law-oriented normative arguments to the corporate law context, as did Phillips in his earlier and much more critical work.⁸²

Eisenberg has fallen well short of providing a convincing justification for maintaining divergent standards of conduct and review in the duty of care area, although again it must be recognized that this was apparently not his primary intention. A more serious attempt at such a justification would have to first of all clearly identify the social benefits that are claimed to result from having divergent standards. If one favors divergence because it bolsters social norms, provides a cushion of safety for persons, and provides scope for needed judicial leniency for violators *a la* Dan-Cohen, one would then need to address the special difficulty that in the corporate fiduciary duty of care context leniency for violators is a zero-sum affair that equals equivalent loss of protections for shareholders. If there are additional social benefits of divergence in the corporate fiduciary duty of care context beyond those described by Dan-Cohen as arising in the criminal law context, these benefits need to be identified and, if possible, quantified. Empirical

81. *Id.* at 465.

82. Phillips, *supra* note 12, at 667-68.

evidence would also need to be marshaled, either to demonstrate that there exists sufficient acoustical separation to make the divergence approach feasible, or else to support Eisenberg's assertions that standards of conduct will significantly affect the behavior of corporate officials even in the absence of acoustical separation.

Finally, one would have to take a position with regard to all of the "rule of law" concerns extensively addressed by Dan-Cohen that are starkly raised by the use of covert and concealed standards of review. It would be necessary to somehow demonstrate that Dan-Cohen's grudging endorsement of covert "dirty hands" measures is not only justified in the criminal law context, but also carries over from the arena of harsh criminal victimization and punishment to the more refined arena of corporate fiduciary duty violations.

III. CONCLUSION

My conclusions should by now be apparent to anyone who has had the patience to read this far. Mier Dan-Cohen has done important work in comprehensively examining and assessing the justifications for having divergent standards of conduct and review. By limiting his arguments to the context of criminal law rules promulgated under circumstances where significant acoustic separation exists he has presented the strongest possible case for maintaining such a divergence. Anyone who reads his article will have to reflect seriously on whether the deterrence/social norm bolstering/cushion of safety benefits and judicial flexibility benefits that he demonstrates may simultaneously result from having unpublicized standards of review that are more lenient than the publicized standards of conduct outweigh the reservations one must have over the legitimacy of this covert and paternalistic approach. Richard Singer in his comprehensive response article has concluded that Dan-Cohen's arguments are ultimately unpersuasive,⁸³ and I agree with him. Reasonable people can certainly reach different conclusions on this close and difficult question, but in my view the illegitimacy of utilizing such means in a society committed to the rule of law outweighs those benefits, significant though they may be in some instances.

The corporate fiduciary duty of care context presents a much more difficult challenge for advocates of maintaining divergent standards. Not only does a covert gross negligence standard of review as compared to the articulated negligence standard of conduct accord more leniency to corporate officials and come at an equivalent cost to corporate shareholders whose protections are correspondingly weakened, but the requisite acoustic separation necessary to avoid creating confusion is unlikely to exist in the corporate context. For these reasons,

83. Singer, *supra* note 8, at 100.

David Phillips concludes that maintaining divergent standards of conduct and review in this area is not justified,⁸⁴ and I am in complete agreement with him. Melvin Eisenberg comprehensively documents the pervasiveness of divergent standards in corporate law, but his article does not add anything of significance to Dan-Cohen's basic normative arguments in favor of maintaining divergent standards beyond asserting without offering proof that standards of conduct that differ from standards of review will influence behavior even absent acoustical separation. Nor does he address either of the troubling special concerns noted above that are raised by attempting to extend those arguments to the corporate fiduciary duty of care context.

I personally do not believe that those specific feasibility and legitimacy concerns raised by having divergent standards in the corporate law context can be adequately addressed. There is no meaningful acoustic separation to work with within this context, there is no evidence that without acoustical separation standards of conduct that differ from standards of review will have significant behavioral effects, and the application of covert standards of review which undercut the articulated shareholder fiduciary duty protections is in my opinion an unacceptable departure from the rule of law. Even if one accepts Dan-Cohen's arguments for maintaining divergent standards in some instances in the criminal law context, which Richard Singer and I do not, David Phillips makes clear, and I hope I have made even clearer, an adequate justification for maintaining divergent standards of conduct and review in the duty of care context still does not exist. This divergence undercuts the commitment to the rule of law, without any evidence that it results in significant social benefits. Therefore judicial and legislative actions should be taken to bring the standards of conduct and review in this area of law into much closer alignment.

84. Phillips, *supra* note 12, at 668.