To Call a Donkey a Racehorse—The Fiduciary Duty Misnomer in Corporate and Securities Law

Marc I. Steinberg

Author ORCID Identifier:

https://orcid.org/0000-0003-0721-1081

Recommended Citation
Marc I. Steinberg, To Call a Donkey a Racehorse - The Fiduciary Duty Misnomer in Corporate and Securities Law, 48 J. CORP. L. 1 (2022)
To Call a Donkey a Racehorse – The Fiduciary Duty Misnomer in Corporate and Securities Law

Marc I. Steinberg*

I. INTRODUCTION

A recurrent theme in corporate law is the presence of directors and officers owing fiduciary duties of care and loyalty to the respective companies (and, collectively, to the shareholders of such companies) for whom they serve. Although not as visible in the

---

* Rupert and Lillian Radford Chair in Law and Professor of Law, SMU Dedman School of Law. I thank Mr. Taylor E. Santori for his research assistance.

securities law setting, concepts of fiduciary duty-like obligations arise with some frequency. Such fiduciaries, as opined by courts, owe the "utmost duty of care and loyalty." Although this rigorous standard was adhered to by a number of courts in times of yesteryear, its faithful application today largely is nonexistent. Nonetheless, courts continue to embrace language in their opinions that emphasizes the continued presence of fiduciary duty standards. Reality, however, strikes a very different key. In fact, standards of fiduciary duty have become greatly diluted in the corporate/securities law setting—to the degree that they should no longer be characterized as being fiduciary-like.

This Article explores this glaring gap between rhetoric and reality and proffers an

---


2. See, e.g., Securities Act § 11(e), 15 U.S.C. § 77k(a) (defining standard of reasonableness with respect to the due diligence defense in the context of a materially misleading statement or omission in a registration statement as "that required of a prudent man [or woman] in the management of his [or her] own property"); see also infra notes 142–163 and accompanying text.

3. See, e.g., Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (stating that a "director's fiduciary duty to both the corporation and its shareholders has been characterized by this Court as a triad: due care, good faith, and loyalty"); Ganter, 965 A.2d at 708–09 ("[O]fficers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors."); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders."); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (stating that corporate directors "stand in a fiduciary relation to the corporation and its stockholders . . . . [and] [t]he rule that requires an undivided and selfless loyalty to the corporation demands that there shall be no conflict between duty and self-interest").

4. See, e.g., Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 599 (1919) ("The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation . . . ."); Sage v. Culver, 41 N.E. 513, 514 (N.Y. 1895) (viewing corporate directors and officers as trustees); John H. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 YALE L.J. 929, 958–59 (2005) ("Initially, the law of corporations applied the trust law sole interest rule to a corporate transaction with a director, and hence the transaction was voidable at the option of the corporation."); Harold Marsh, Jr., Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 BUS. LAW. 35, 36 (1966) ("In 1880, it could have been stated with confidence that in the United States the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction."); Comment, "Interested Director's" Contracts — Section 713 of the New York Business Corporation Law and the "Fairness" Test, 41 FORDHAM L. REV. 639, 640 (1973) ("According to the weight of authority, at early common law, a contract between a director and his corporation, or between corporations with interlocking directorates, was voidable at the option of either corporation.") (citing, inter alia, CHARLES B. ELLIOTT, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS §§ 505–07 (3d ed. 1900)).

5. See discussion infra notes 31–135 and accompanying text.


7. See discussion infra notes 31–135 and accompanying text.
alternative approach aligned with the present-day actuality of so-called fiduciary principles. Unlike partnership and limited liability company law, where fiduciary duties have been diluted and even eliminated upon contractual agreement, corporate law continues to exhort the continual presence of a subject company’s officers’ and directors’ fiduciary duties of care and loyalty. This theme extends, somewhat indirectly, to the securities law context. Although generally premised on concepts of disclosure rather than substantive fairness, the securities laws nonetheless recognize principles of fiduciary duty with respect to the relationship between corporate insiders and the corporations and shareholders for whom they serve.

This Article thus explores this illusion that courts continue to embrace. First, the Article addresses the multi-faceted contexts in which state courts cling to fiduciary duty principles in their rhetoric yet apply far more lax standards in their liability assessments. Thereafter, a similar phenomenon is analyzed with respect to the application of federal securities laws. What will become clear is that the liability exposure of officers and directors ordinarily is not scrutinized consistently with fiduciary principles. The last part of this Article advocates for the recognition of reality rather than imaginary characterizations, setting forth a cognizable framework for determining the appropriate liability thresholds that should be implemented.

II. RHETORIC AND REALITY ADDRESSING FIDUCIARY CONDUCT IN THE CORPORATE SETTING

Present-day corporate law continues to embrace concepts of fiduciary duty when analyzing the conduct of corporate officers and directors. Application of fiduciary duty standards prevails in evaluating director and officer conduct in duty of care and duty of loyalty situations, encompassing conflict of interest transactions and the exercise of good faith. Fiduciary duty concepts also arise when assessing the propriety of controlling

---

8. See discussion infra notes 19–30 and accompanying text.
9. See cases cited supra notes 1, 6; discussion infra notes 31–135 and accompanying text.
10. See, e.g., Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477–78 (1977) (noting that “[the] court repeatedly has described the ‘fundamental purpose’ of the [Securities Exchange] Act as implementing a ‘philosophy of full disclosure;’ once full and fair disclosure has occurred, the fairness of the transaction is at most a tangential concern of the statute”) (citing Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 381–85 (1970)); see generally Ralph C. Ferrara & Marc I. Steinberg, A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism, 129 U. Pa. L. Rev. 263, 301 (1980) (reflecting that “the federal judiciary, particularly the Supreme Court, has become acutely aware that undue extension of the Rule 10b-5 remedy into previously untouched areas may displace regulation that has traditionally been within the purview of the states”). For my recent book addressing this subject, see MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE 138–40 (Oxford Univ. Press 2018).
11. A key example is insider trading law, where fiduciary duty principles are implicated. See discussion infra notes 164–73 and accompanying text.
12. See, e.g., Lewis v. S. L. & E., Inc., 629 F.2d 764 (2d Cir. 1980) (applying New York law with respect to related party transactions); Stone v. Ritter, 911 A.2d 362 (Del. 2006) (interpreting the duty of good faith and holding that failure to comply with this duty breaches the duty of loyalty); Branc v. Roth, 590 N.E.2d 587 (Ind. 1993) (holding corporate directors liable for breach of the duty of care).
shareholder conduct.  

The initial inquiry, of course, is the meaning of the term "fiduciary" in this context.  

Black's Law Dictionary provides a succinct and pointed definition, stating a fiduciary is "[s]omeone who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, loyalty, due care, and disclosure <the corporate officer is a fiduciary to the corporation>,"  

Turning to case law, Justice Cardozo's eloquent statement in Meinhard v. Salmon comes to mind—that a partner's conduct is to be measured "[n]ot [by] honesty alone, but the punctilio of an honor the most sensitive,"signifying that "the duty of the finest loyalty" is the governing standard of behavior.  

As discussed in this Article, this standard rarely is applied today in business enterprise law. Nonetheless, unlike corporate law, the applicable framework for partnership and limited liability company law acknowledges that these elevated standards of fiduciary conduct frequently are no longer recognized when the participants contractually elect to limit or eliminate fiduciary duties.  

A. Fiduciary Duty Application in the Partnership and Limited Liability Company (LLC) Settings  

Unlike days of yesteryear, partnership law slights the fiduciary standard enunciated by Justice Cardozo in Meinhard. Indeed, the Uniform Partnership Act (UPA) declines to categorize a partner's duty of care as fiduciary. And for good reason, as a partner's standard of conduct is "to refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or a knowing violation of law." The 2001 Uniform Limited Partnership Act (ULPA) contains identical language. While meriting kudos for at least recognizing the abandonment of a fiduciary duty of care standard, the same level of candor is lacking in the duty of loyalty context. For example, both the UPA and ULPA specify that a partner's fiduciary duty of loyalty arises in certain situational settings. Nonetheless, pursuant to the partnership agreement, unless "manifestly unreasonable," aspects of the

---

14. Fiduciary, BLACK'S LAW DICTIONARY (11th ed. 2019). The author is on the Panel of Academic Contributors for this work. See id. at vi.
15. 164 N.E. 545 (N.Y. 1928).
16. Id. at 546.
17. See id. (opining that "[j]oint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty [and that] [m]any forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties").
18. See discussion infra notes 19-30 and accompanying text.
20. UPA § 409(c); see Comments to § 409(c) ("The Act no longer refers to the duty of care as a fiduciary duty.").
21. See UNIF. LTD. P'SHIP ACT § 409(c) (UNIF. L. COMM. 2001).
22. See id. § 409(b); UNIF. P'SHIP ACT § 409(b). These duties include the obligation to refrain from improperly taking a corporate opportunity, competing with the partnership, and misappropriating corporate assets.
duty of loyalty may be altered or eliminated. This type of behavior clearly is not characteristic of the traditional standards to which fiduciaries have been held accountable. A Comment to the UPA reflects this reality, recognizing that “[a]rguably, the term ‘fiduciary’ is inappropriate when used to describe the duties of a partner because a partner may legitimately pursue self-interest . . . [but] partners have long been characterized as fiduciaries.”

Hence, adhering to a contractarian premise, the modern partnership acts to minimize traditional standards of fiduciary duty. The fiduciary nature of the partnership relationship thus has been diminished. In its stead, a contractarian approach has become the dominant force.

Fiduciary relationships in the limited liability company follow a similar pattern. While courts exhort that LLC members owe one another the utmost duty of loyalty, the applicable operating agreement may permit members to engage in self-dealing and related activities that redound to the detriment of the LLC and its members. Like in the partnership context, LLC agreements may contract around fiduciary duties that otherwise would be owed. Indeed, in a number of states, such as Delaware, the LLC operating agreements may alter or eliminate the aspects of the duty of loyalty stated in Section 409(b); (B) identify specific types or categories of activities that do not violate the duty of loyalty . . . .”); UNIF. LTD. P'SHIP ACT § 105(d)(1) (similar language).

23. See UNIF. P'SHIP ACT § 105(d)(3)(A)–(B) (“If not manifestly unreasonable, the partnership agreement may: (A) alter or eliminate the aspects of the duty of loyalty stated in Section 409(b); (B) identify specific types or categories of activities that do not violate the duty of loyalty . . . .”); UNIF. LTD. P'SHIP ACT § 105(d)(2)(A)–(B). For a judicial decision illustrating this principle, see J & J Celcom v. AT&T Wireless Serv., Inc., 169 P.3d 823 (Wash. 2007) (upholding applicability of partnership agreement provision in the duty of loyalty context).


26. See, e.g., Alan W. Vestal, Fundamental Contractarian Error in the Revised Uniform Limited Partnership Act of 1992, 73 B.U. L. REV. 523, 535 (1993) (criticizing “the drafters’ rejection of the fiduciary essence of the partnership relationship in favor of the contractarian premise” and asserting that “the drafters ha[d] made the partners adversaries, whereas before they were bound by ‘the finest duty of loyalty’”).

27. See, e.g., Feeley v. NHAOCG, L.L.C., 62 A.3d 649, 661 (Del. Ch. 2012) (stating that “the Delaware Limited Liability Company Act . . . contemplates that equitable fiduciary duties will apply by default to a manager or managing member of a Delaware LLC”); Miller v. FiberLight, L.L.C., 808 S.E.2d 593, 598 (Ga. Ct. App. 2017) (“When a Delaware limited liability company agreement is silent on the issue of fiduciary duties, Delaware law now imposes default fiduciary duties.”); McConnell v. Hunt Sports Enters., 725 N.E.2d 1193, 1214 (Ohio Ct. App. 1999) (“In the case at bar, a limited liability company is involved which, like a partnership, involves a fiduciary relationship.”).

28. For example, in McConnell, the operating agreement, as construed by the court, permitted the LLC members to compete with the enterprise. See 725 N.E.2d at 1206–23; id. at 1216 (stating that the LLC’s operating agreement specifically allowed its members to compete with the company).

29. See Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999) (“The basic approach of the Delaware [Limited Liability Company] Act is to provide members with broad discretion in drafting the Agreement and to furnish default provisions when the members’ agreement is silent.”); In re W.J. Bradley Mortg. Cap., L.L.C., 598 B.R. 150, 165 (Bankr. D. Del. 2019) (“It is the case that ‘[c]ourts recognize contractual agreements where the fiduciary duties have been limited.’”); Ross Holding & Mgmt. Co. v. Advance Realty Grp., L.L.C., No. 4113, 2014 WL 4374261, at *12 (Del. Ch. Sept. 4, 2014) (“By default, the traditional fiduciary duties applicable to corporations apply to limited liability companies. Nonetheless, where such default rules have been clearly supplanted or modified, those contractual choices will be respected.”).
agreement can eliminate fiduciary duties in their entirety.\footnote{30. See Delaware Limited Liability Act § 18-1101(b) ("It is the policy of [the Act] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); Auriga Cap. Corp. v. Gatz Props., L.L.C., 40 A.3d 839, 852 (Del. Ch. 2012) (observing that "the [LLC] statute allows the parties to an LLC agreement to entirely supplant those default principles or to modify them in part"); In re Atlas Energy Res., L.L.C., No. 4589, 2010 WL 4273122, at *12 (Del. Ch. Oct. 28, 2010) (stating that the LLC Agreement "unambiguously eliminates the traditional fiduciary duties of [the company's] directors and officers. Thus, the only duties owed by the [directors] are those set forth elsewhere in the LLC Agreement"); Myron T. Steele, Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies, 32 DEL. J. CORP. L. 1, 4 (2007) (concluding that "parties to contractual entities such as limited liability partnerships and limited liability companies should be free—given a full, clear disclosure paradigm—to adopt or reject any fiduciary duty obligation by contract").}

Unlike partnerships and limited liability companies, the recognition of fiduciary duties is ensconced in corporate law. Nonetheless, as the following discussion illustrates, this recognition is largely illusory. Although ringing with rhetoric, the substance of fiduciary duty law in the corporate setting ordinarily lacks meaningful content.

**B. Fiduciary Duty Application in the Corporate Law Setting**

With regularity, courts emphasize that corporate officers and directors owe fiduciary duties to their corporations and, collectively, to the shareholders for whom they serve.\footnote{31. See, e.g., cases cited supra notes 1, 3.} As phrased by the Delaware Supreme Court, in carrying out their obligatory roles, "directors are charged with an unyielding fiduciary duty to the corporation and its shareholders."\footnote{32. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch. 1938)).} This strong language, however, is minimized by the actuality of lax standards that are applied by the courts. This distinction between rhetoric and reality is explored below.

**1. The Duty of Care**

Pursuant to state corporate law principles, directors and officers owe a fiduciary duty of care to their corporation and its shareholders.\footnote{33. See, e.g., Francis v. United Jersey Bank, 432 A.2d 814 (N.J. 1981); Branc v. Roth, 590 N.E.2d 587 (Ind. Ct. App. 1993); Senn v. Nw. Underwriters, Inc., 875 P.2d 637 (Wash. Ct. App. 1994).} There is much rhetoric to support this standard. For example, with respect to the standard of conduct for directors, the Model Business Corporation Act provides that these individuals "shall discharge their obligations with the care that a person in a like position would reasonably believe appropriate under similar circumstances."\footnote{34. MODEL BUS. CORP. ACT § 8.30(b).} But, as the Comment to the provision sets forth, this standard does not address the liability exposure that a director would incur for noncompliance.\footnote{35. Id. Official Comment (stating that Section 8.30 "addresses standard of conduct-the level of performance expected of directors undertaking the role and responsibilities of the office of director [but] does not address the liability of a director").}

In fact, director liability for breach of the duty of care is rare.\footnote{36. This point was poignantly made by Professor Joseph Bishop over fifty years ago. See Joseph Bishop, Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers, 77 YALE L.J. 1078, 1099 (1968) ("The search for cases in which directors of industrial corporations have been held...".)} Several reasons explain...
this situation. As an initial point, the duty of care ordinarily becomes a focus only if the corporate fiduciary declines to make a decision. When a decision is made without a disabling conflict of interest to either abstain or take action, the permissive business judgment rule is normally the prevailing standard. As discussed below, this standard is inconsistent with the faithful application of fiduciary duty analysis. Providing even broader protection, director exculpation statutes authorize the avoidance of duty of care monetary liability altogether, rendering such directors subject to liability exposure for engaging in only more culpable misconduct involving knowing misconduct or duty of loyalty breaches. Moreover, in practice, courts often apply lax interpretations of the requisite conduct that a fiduciary must engage in to comply with the duty of care. The consequence is that a fiduciary’s alleged failure to comply with the duty of care has been subject to relatively sparse judicial construction and the rare imposition of liability.

2. The Business Judgment Rule

The business judgment rule limits much of fiduciary duty applicability in the corporate setting. Stated succinctly, the business judgment rule insulates a board of
directors’ determination from successful challenge if a deliberative decision was made without a disabling conflict of interest, provided that the decision was adequately informed and had a rational basis. The level of culpability required for rebutting the business judgment rule is that of gross negligence—a culpability level that is sufficient for the imposition of punitive damages in other contexts.

In one of the striking oxymorons of corporate law—which has gone largely unnoticed—the Delaware Supreme Court opined that directors have “an unyielding fiduciary duty,” yet held that this duty is to be measured under the business judgment rule by “concepts of gross negligence.” As defined in Black’s Law Dictionary, gross negligence is “the omission of even such diligence as habitually careless and inattentive people do actually exercise in avoiding danger to their own person or property.” The illusion of corporate directors as fiduciaries is poignant in this setting. At one moment, the Delaware Supreme Court identifies this unyielding fiduciary duty, asserting that “[r]epresentation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances present.” Two paragraphs thereafter, the court holds that the standard to determine whether a subject director adheres to these fiduciary obligations in the business judgment rule setting is that of gross negligence. To state that a director acts in a law-compliant manner when she acts without gross negligence calls into question whether such director, in actuality, is a fiduciary.

The breadth of the business judgment rule to shield directors from liability is a constant theme in corporate law. The rule is invoked to insulate directors from liability, even though they acted with negligence, for a wide range of deliberative decisions. Traditionally, the rule addressed entrepreneurial or managerial decisions made by a board

43. See PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (AM. L. INST. 1994).
44. See, e.g., Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (stating that “under the business judgment rule director liability is predicated upon concepts of gross negligence”); cf. United Food, 262 A.3d at 1057 (holding that “excused care violations no longer pose a sufficient threat to excuse demand [on the board of directors prior to initiating a shareholder derivative action] under the second prong of the Aronson test”).
45. See Gross Negligence, BLACK’S LAW DICTIONARY (11th ed. 2019) (defining gross negligence as “[a] conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party, who may typically recover exemplary damages”).
47. Id. at 873 (citing Aronson v. Lewis, 473 A.2d 805 (Del. 1984)).
49. Van Gorkom, 488 A.2d at 872 (stating that “[s]uch obligation does not tolerate faithlessness or self-dealing”).
50. Id. at 873 (quoting Aronson, 473 A.2d at 812). To the surprise and dismay of practitioners and several commentators, the Delaware Supreme Court held that the directors violated their duty of care. By acting in a grossly negligent manner in not being adequately informed regarding the subject merger transaction, the directors incurred monetary liability. See id. at 890–93. The decision has been subject to extensive criticism. See, e.g., Daniel Fischel, The Business Judgment Rule and the Trans Union Case, 40 BUS. LAW. 1437, 1455 (1985) (describing Van Gorkom v. Smith as “one of the worst decisions in the history of corporate law”); Bayless Manning, Reflections and Practical Tips on Life in the Boardroom After Van Gorkom, 41 BUS. LAW. 1, 1 (1985) (stating that “the corporate bar generally views the decision as atrocious”). But see William Pickett, An Explanation of Trans Union to “Henny-Penny” and Her Friends, 10 DEL. J. CORP. L. 451, 452 (1985) (asserting that the court “in light of pre-existing Delaware law could not decide the [case] in any other way, faced with the horrendous factual record”).
of directors, such as whether to launch a new product, enter into a substantial contract with a vendor, or terminate the company’s chief executive officer. In this context, the rule is employed as a shield to deflect shareholder challenges that the defendant directors engaged in actionable misconduct. More recently, the rule has been invoked as a sword, authorizing special litigation committees comprised of independent and disinterested directors to procure the dismissal of allegedly meritorious shareholder derivative suits. The rule also is applied in the mergers and acquisitions setting whereby a board of directors may adopt poison pills and saddle the company with billions of dollars of debt with the objective of maintaining such company’s independence. Likewise, the business judgment rule is the governing standard in decisions made by the directors of an acquirer company in their determination whether to launch a takeover bid that, if consummated, would fundamentally restructure their corporation.

Many of these decisions are monumental. In publicly-held companies, they impact fundamental issues regarding the subject corporation’s financial well-being, corporate governance, and investor protection. Given their importance, it is not surprising that corporate law places upon directors and officers fiduciary obligations to act in the corporation’s best interests.

51. For example, in Shlensky v. Wrigley, the business judgment rule was applied to uphold the decision by the board of directors of the Chicago National League Ball Club to refrain from installing lights in Wrigley Field (the home park of the Chicago Cubs) and scheduling night games. 95 Ill. App. 2d 173 (1968); see also Scott Simon, Let’s Play Two! Remembering Chicago Cub Ernie Banks, NAT’L PUB. RADIO (Jan. 24, 2015), https://www.npr.org/2015/01/24/379546360/lets-play-two-remembering-chicago-cub-ernie-banks [https://perma.cc/M5FZ-H475].

52. See, e.g., Davis v. Louisville Gas & Elec. Co., 142 A. 654, 659 (Del. Ch. 1928) (stating that the directors of a subject corporation pass upon “questions of policy and business management” and their determination, “[u]nless shown to be tainted with fraud, is accepted as final”).


54. See, e.g., Versata Enters. v. Solectica, Inc., 5 A.3d 586 (Del. 2010); Paramount Commc’ns, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989); Revlon, Inc. v. Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). As the foregoing cases hold, the traditional business judgment rule does not apply in Delaware with respect to defensive tactics undertaken by the target’s board of directors seeking to maintain the company’s independence or to effectuate a long-term business strategy. Before the business judgment rule may be applied in this setting, corporate fiduciaries must establish that there existed “reasonable grounds for believing [that the takeover threat presented] a danger to corporate policy and effectiveness” and that the defensive actions taken were “reasonable in relation to the threat posed.” Unocal, 493 A.2d at 955. In practice, this standard “may well be of cosmetic value, having little substantive impact.” Marc I. Steinberg, Tender Offer Regulation: The Need for Reform, 23 WAKE FOREST L. REV. 1, 15 (1988). Over forty years ago, I coauthored one of the first articles focusing on defensive maneuvers in tender offers. See Gary G. Lynch & Marc I. Steinberg, The Legitimacy of Defensive Tactics in Tender Offers, 64 CORNELL L. REV. 901 (1979).


57. See, e.g., cases cited supra notes 1, 3, 6, 12.
fiduciary standards, including the prominence of the business judgment rule,\textsuperscript{58} evidence that a substantial gap exists between rhetoric and reality. This gap is widened by the exculpation statutes that insulate a subject director from monetary damages for misconduct that is grossly negligent.\textsuperscript{59} To assert that an officer or director can engage in such behavior yet act consistently with her fiduciary obligations is illogical.\textsuperscript{60} 

3. The Duty of Good Faith

Not surprisingly, this fiction extends to duty of loyalty situations. The duty of good faith, an aspect of a fiduciary’s duty of loyalty,\textsuperscript{61} presents a similar problematic scenario. “Good faith” has been defined as adhering to conduct that is faithful “to one’s duty or obligation.”\textsuperscript{62} Taking a strikingly more narrow perspective, the Delaware courts adhere to a far different standard.\textsuperscript{63} Under Delaware law, a failure of a director or officer to act in

\textsuperscript{58} As the Delaware Supreme Court held in \textit{Gantler v. Stephens}, “officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors.” 965 A.2d 695, 709 (Del. 2009). Whether the business judgment rule may be invoked by officers is unresolved. Compare Frederick Hsi Living Tr. v. ODN Holding Corp., No. 12108, 2017 WL 1437308, at *39 (Del. Ch. Apr. 14, 2017)(“[C]orporate officers owe fiduciary duties that are identical to those owed by corporate directors. . . . Like directors, officers breach the duty of loyalty if they ‘act[] in bad faith for a purpose other than advancing the best interests of the corporation.”), and \textit{PRINCIPLES OF CORP. GOVERNANCE}, supra note 43, § 4.01 (applying the business judgment rule to both corporate officers and directors), with F.D.I.C. v. Van Dellen, No. CV 10-4915, 2012 WL 4815159, at *7 (C.D. Cal. 2012) (opining that “as to California substantive law—the state’s business judgment rule does not protect officers”), and Lyman P.Q. Johnson, \textit{Corporate Officers and the Business Judgment Rule}, 60 BUS. LAW. 439, 440 (2005) (asserting that the business judgment rule “does not and should not be extended to corporate officers in the same broad manner in which it is applied to directors”). Professor Johnson’s position is responded to by Professor Lawrence A. Hamermesh and A. Gilchrist Sparks III, \textit{Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson}, 60 BUS. LAW. 865, 865 (2005) (contending that “the policy rationales underlying the development and application of the business judgment rule to corporate directors similarly justify application of the rule to non-director officers, at least with respect to the exercise of discretionary delegated authority”).

\textsuperscript{59} The Delaware exculpation statute is addressed in supra note 40. A number of states provide even greater protection for corporate directors. See, e.g., MD. CORPS. & ASS’NS CODE ANN. §§ 2-405.2, 2-418 (West 2020) (providing that, absent the receipt of an improper benefit, officers and directors are monetarily liable only if they engage in “active and deliberate dishonesty”); NEV. REV. STAT. § 78.138 (2021) (providing for director and officer liability limitations unless it is proven that the individual’s “act or failure to act constituted a breach of his or her fiduciary duties” and the breach “involved intentional misconduct, fraud or a knowing violation of law”); VA. CODE ANN. § 13.1-692.1 (2021) (providing limits on director and officer liability except to the extent the individual “engaged in willful misconduct or a knowing violation of the criminal law or of any federal or state securities law”).

\textsuperscript{60} Note that many of these exculpation statutes, such as the Delaware statute, do not apply where injunctive or other non-monetary relief is sought. See DEL. GEN. CORP. L. § 102(b)(7). In such situations, the exculpation statute does not eliminate a director’s duty of care. See Malpiede v. Townsend, 780 A.2d 1075, 1095 (Del. 2001). For other Delaware decisions construing Section 102(b)(7), see, for example, Zirn v. VLI Corp., 621 A.2d 773 (Del. 1993) (holding that as certain claims for monetary damages alleged breach of the duty of loyalty, no shield provided by the statute); Arnold v. Soc’y for Savs. Bancorp, Inc., 650 A.2d 1270 (Del. 1994) (finding no duty of loyalty violation by defendants, the court applied the corporate charter provision authorized by statute to exculpate directors from monetary damages).

\textsuperscript{61} See, e.g., Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (opining that “because a showing of bad faith conduct . . . is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty”).

\textsuperscript{62} \textit{Good faith}, \textit{BLACK’S LAW DICTIONARY} (11th ed. 2019).

\textsuperscript{63} See discussion \textit{infra} notes 64–72 and accompanying text.
good faith may be established, for example, by the fiduciary: (1) intentionally engaging in conduct for a purpose other than that of furthering the corporation's best interests; (2) acting with the motive of violating applicable positive law; or (3) failing to act when there is a known duty to act, thereby exhibiting a conscious disregard for complying with such fiduciary's duties. By cabining the subject fiduciary's breach of good faith to intentional misconduct, this obligation is substantially limited.

The difference between rhetoric and substance in this context is illustrated when ascertaining the requisite degree of a director's oversight function with respect to law compliance. The Delaware Supreme Court in *Stone v. Ritter* recognized that “it is important that the board exercise its good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.” Making clear that this exhortation did not define the applicable legal standard, the court established narrow liability parameters. In order to hold directors liable for lack of good faith with respect to their oversight functions, it must be proven that:

(a) the directors *utterly failed* to implement any reporting or information system or controls; or (b) having implemented such a system or controls, *consciously failed* to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring their attention.

Hence, under this standard, directors act in bad faith and thereby breach their duty of loyalty by “utterly” or “consciously fail[ing]” to adhere to their law compliance oversight obligations.

Pursuant to this standard, a director incurs liability only where there is an utter or

64. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006); see *Stone*, 911 A.2d at 369 (approvingly quoting *Disney* and stating that "a failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence)").

65. This is the third example set forth above by the Delaware Supreme Court identifying when a director or officer fails to act in good faith. See supra note 64 and accompanying text.


67. 911 A.2d 362 (Del. 2006).

68. Id. at 368 (quoting *Caremark*, 698 A.2d at 970).

69. *Stone*, 911 A.2d at 370 (emphasis added). The court stated that either of these failures requires "a showing that the directors knew that they were not discharging their fiduciary obligations." Id.

70. Id. ("In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations."); see also H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 DEL. J. CORP. L. 1 (2001) (discussing board compliance oversight responsibility in light of SEC, ALI, and ABA pronouncements); Mercer Bullard, *Caremark Irrelevance*, 10 BERKELEY BUS. L.J. 15 (2012) (commenting that application of other federal and state laws posing a financial risk to corporations and their fiduciaries incentivizes the adoption and implementation of reasonably effective law compliance systems); E. Norman Veasey & Randy J. Holland, *Caremark at the Quarter-Century Watershed: Modern-Day Compliance Realities Frame Corporate Directors' Duty of Good Faith Oversight, Providing New Dynamics for Respecting Chancellor Allen's 1996 Caremark Landmark*, 76 BUS. LAW. 1 (Winter 2020–2021) (discussing developments that address the board of directors' oversight obligations).
deliberate failure to comply with her oversight responsibility.\textsuperscript{71} To confine a director’s liability exposure in this manner is antithetical to the meaning of fiduciary status. Avoidance of liability as a fiduciary should require the undertaking of a significantly more vigilant oversight role. For purposes here, to impose liability only in these limited circumstances upon corporate fiduciaries tellingly conveys that directors in their oversight role are fiduciaries in name only, lacking substantive meaning.\textsuperscript{72}

4. The Duty of Loyalty

In addition to the duty of good faith discussed above, the violation of which constitutes a breach of the duty of loyalty,\textsuperscript{73} numerous other situations implicating the duty of loyalty likewise illustrate the distinction between rhetoric and actuality in ascertaining the propriety of fiduciary conduct. For example, with respect to the legitimacy of interested director transactions,\textsuperscript{74} provided that a subject transaction is approved by the requisite number of independent directors who are privy to sufficient information,\textsuperscript{75} such transaction

\textsuperscript{71} Such a failure was adequately pled in \textit{Marchand v. Barnhill}, 212 A.3d 805 (Del. 2019). In that case, directors and two executive officers of Blue Bell Creameries U.S.A., Inc. were sued for, \textit{inter alia}, breaching their duty of good faith and, hence, their duty of loyalty. Due to a listeria outbreak in its manufacturing plants, Blue Bell incurred financial injury. The court held that the plaintiff’s allegations were sufficient to state this claim, stating:

\textquote{\textit{Id.} at 822 (emphasis added); cf. Firemen’s Ret. Sys. of St. Louis v. Sorenson, No. 2019-0965, 2021 WL 4593777, at *18 (Del. Ch. Oct. 5, 2021) (dismissing the complaint for a failure to make a demand on the board of directors, reasoning that “the difference between a flawed effort [to respond swiftly to internal reports regarding the company’s inadequate data security risks] and a deliberate failure to act is one of extent and intent [and \textit{Caremark} requires a plaintiff to demonstrate the latter”); \textit{Marchand v. Barnhill}, 212 A.3d 805, 823 (Del. 2019) (recognizing that “plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight”).

\textsuperscript{72} Notably, corporate directors and officers may incur liability exposure under state and federal law for their companies’ noncompliance with regulatory mandates. \textit{See ABA Corp. L. Comm., Corporate Director’s Guidebook} 37–43 (7th ed. 2020). Although the adoption and implementation of reasonably effective law compliance programs are deemed core functions of the board, liability under state corporate law principles lags behind customary practice. The antiquated and unduly lax liability standard set forth by the Delaware Supreme Court is antithetical to the sound enforcement of essential corporate governance principles.

\textsuperscript{73} \textit{See supra} notes 61–72 and accompanying text.

\textsuperscript{74} Generally, an interested director transaction is a “contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest . . . .” Del. Gen. Corp. L. § 144. Such a transaction may be enforceable if there is adherence to applicable judicial authority and the specified procedures set forth in the statute. \textit{Id.; see also} sources cited \textit{supra} note 4; \textit{infra} note 76.

\textsuperscript{75} As stated in Section 144(a)(1) of the Delaware statute:

The material facts as to the director’s or officer’s relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the
can be successfully challenged in Delaware only if the complainant rebuts the presumption of the business judgment rule.76 A number of other states are even more protective of director interests, providing that duly authorized approval of the transaction by independent directors who are privy to requisite information insulates such transaction from successful challenge.77 In these states, once the specified procedural hurdles are satisfied,78 shareholders alleging a fiduciary’s conflicting interest have no path to pursue judicial review of the underlying interested director transaction.79 The approaches adopted by Delaware and other states are not consonant with director fiduciary status: Authorizing independent directors successfully to preclude meritorious shareholder litigation against allegedly self-dealing directors pursuant to the business judgment rule or more lenient standard, even when such independent directors act negligently when making their determinations, contravenes the standards by which fiduciaries should be held accountable.80

76. See Marciano v. Nakash, 535 A.2d 400, 405 n.3 (Del. 1987) (stating that “approval by fully informed disinterested directors ... or disinterested shareholders ... permits invocation of the business judgment rule ... ”); accord, PRINCIPLES OF CORP. GOVERNANCE, supra note 43, § 5.02(a)(2); see also Emerald Partners v. Berlin, 726 A.2d 1215, 1222–23 (Del. 1998) (describing how the burden of proof on the issue of fairness may shift, including approval by an independent committee of directors); Kahn v. Lynch Commc’ns Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) (applying burden-shifting rule).


78. For example, under these statutes, approval in good faith by disinterested directors (though constituting less than a quorum) who have knowledge of the material facts as to the transaction or contract insulates such transaction or contract from successful shareholder challenge. See statutes cited supra note 77.

79. See MBCA § 8.62 Official Comment (stating that if, with requisite disclosure, disinterested shareholder or director approval is procured with respect to the interested director transaction, “then a director’s conflicting interest transaction is immune from attack by a shareholder or the corporation on the ground of an interest of the director”).

80. For example, the Delaware statute merely requires that the disinterested directors, apprised of the requisite material information, approve the interested director transaction “in good faith.” DEL. GEN. CORP. L. § 144(A)(1). As discussed above, the good faith standard insulates fiduciaries from liability unless they engage in aberrant behavior. See supra notes 61–72 and accompanying text. Once this approval is procured, then the gross negligence standard of the business judgment rule becomes applicable. See Marciano, 535 A.2d at 405 n.3. The laxity that courts apply to interested director transactions was criticized over fifty years ago by Professor Marsh. See Harold Marsh, Jr., Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 BUS. LAW. 35 (1966). The late nineteenth-century case law that Professor Marsh relied upon to opine that judicial scrutiny of related party transactions was far more rigorous has been challenged by other scholars. See, e.g., DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW 323 (2018) (“Although Marsh’s view of the evolution of self-dealing regulation is widely accepted in the U.S. corporate legal debate, it is not correct.” (citing Norwood P. Beveridge, Jr., The Corporate Director’s Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction, 41 DEPAUL L. REV. 655 (1992))). In a recent article, Professor Bratton nonetheless acknowledges that the “erosion of the standards that courts apply to management self-dealing has continued unabated since Marsh published in 1966 and even though there is no reason to think that management self-dealing benefits the shareholder interest.” William W. Bratton, Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law, 76 BUS. LAW. 1157, 1159 (2021); accord Julian Velasco, The Diminishing Duty of Loyalty, 75 WASH & LEE L. REV. 1035 (2018).
Likewise, in shareholder derivative litigation, the business judgment rule is the governing standard in many jurisdictions in a court’s determination of whether to dismiss the litigation based on the recommendation by the subject corporation’s special litigation committee comprised of independent and disinterested directors.\textsuperscript{81} By dismissing the lawsuit in this context, the propriety of the underlying alleged self-dealing transaction engaged in by a defendant fiduciary is not within the purview of the court’s decision.\textsuperscript{82} The court’s focus is solely on whether the special litigation committee met the criteria of the business judgment rule in its recommendation that the subject lawsuit is not in the corporation’s best interests.\textsuperscript{83} This approach minimizes the reality that directors are passing judgment on their fellow directors, assessing whether litigation alleging misconduct—often alleged financial impropriety implicating the duty of loyalty—should go forward.\textsuperscript{84}

Allowing otherwise meritorious derivative litigation alleging breaches of fiduciary duty premised on the duty of loyalty against corporate insiders to be dismissed under the business judgment rule contravenes fiduciary principles on several grounds. First, it slights the structural bias of the members of the special litigation committee, who frequently have similar backgrounds as their fellow defendant directors.\textsuperscript{85} Second, this approach minimizes the collegiality and affinity that develop over time that are shared among directors.\textsuperscript{86} Third, pursuant to the business judgment rule’s application in this setting, the underlying insider

\textsuperscript{81} See, e.g., Hirsch v. Jones Intercable Inc., 984 P.2d 629 (Colo. 1999); Boland v. Boland, 31 A.3d 529 (Md. 2011); In re United Health Grp. Inc. S’holder Derivative Litig., 754 N.W.2d 544 (Minn. 2008); Auerbach v. Bennett, 47 N.Y. 619 (1979); Desigoudar v. Meyercord, 133 Cal. Rptr. 2d 408 (Ct. App. 2003).

\textsuperscript{82} See, e.g., Zapata Corp. v. Maldonado, 430 A.2d 779, 784 (Del. 1981) (“Consistent with the purpose of requiring a demand [on the board of directors], a board decision to cause a derivative suit to be dismissed as detrimental to the company, after demand has been made and refused, will be respected unless it was wrongful.”); see also id. at 785–89 (establishing a two-step test for a court’s determination whether to dismiss a derivative suit in demand-excused cases).

\textsuperscript{83} See supra note 81.

\textsuperscript{84} See Zapata, 430 A.2d at 787 (recognizing that the court “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”).

\textsuperscript{85} The concept of structural bias in the corporate governance setting has been recognized for many decades. See, e.g., Clark v. Lomas & Nettleton Fin. Corp., 625 F.2d 49, 53–54 (5th Cir. 1980) (acknowledging the existence of structural bias, holding that conflicts of interest precluded the board from compromising shareholders’ derivative claims), cert. denied, 450 U.S. 1029 (1981); Houle v. Low, 556 N.E.2d 51, 54 (Mass. 1990) (acknowledging that concern of structural bias of special litigation committees “is not unfounded”); 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) (recognizing structural bias in board determinations and stating that “a derivative action evokes a response of group loyalty, so that even a ‘maverick’ director may feel compelled to close ranks and protect his fellows from the attack of the ‘strike suiter’”). Structural bias may be defined as “inherent prejudice . . . resulting from the composition and character of the board of directors.” Note, The Business Judgment Rule in Derivative Suits Against Directors, 65 CORNELL L. REV. 600, 601 n.14 (1980).

\textsuperscript{86} See Zapata, 430 A.2d at 787; James D. Cox & Harry L. Munsinger, Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion, 48 LAW & CONTEMP. PROBS. 83, 85 (1985) (concluding that “several psychological mechanisms can be expected to generate subtle, but powerful, biases which result in the independent directors’ reaching a decision insulting colleagues on the board from legal sanctions”); Antony Page, Unconscious Bias and the Limits of Director Independence, 2009 U. ILL. L. REV. 237 (2009) (analyzing degree of bias among directors in the board decision-making process); Julian Velasco, Structural Bias and the Need for Substantive Review, 82 WASH. U. L.Q. 821 (2004) (recognizing the presence of structural bias impacting board decisions and proposing the adoption of a revised standard to address this deficiency in order to provide an appropriate balance between director accountability and authority).
financial transaction being challenged is not subject to judicial scrutiny. Although not to the liking of the Delaware Supreme Court, the Chancery Court's language offers a far more pro-investor approach: "Aggrieved stockholders of Delaware corporations ought to be able to expect that an impartial tribunal, and not a committee appointed by the alleged wrongdoers, will decide whether a stockholder's derivative suit alleging breach of fiduciary duty has any merit." Maldonado v. Flynn, 413 A.2d 1251, 1263 (Del. Ch. 1980).

The alleged usurpation of a corporate opportunity by an officer or director provides another scenario evidencing the gap between fact and myth. Under the corporate opportunity doctrine, absent independent director approval, a fiduciary cannot take for her own benefit an opportunity that belongs to the subject corporation. There is no uniform standard for defining the presence of a corporate opportunity. For example, courts apply the interest or expectancy test, the line of business test, and the fairness test. Regardless of which test is applied, the prospect may be the same: namely, a fiduciary's

87. See cases cited supra notes 81–82. Although not to the liking of the Delaware Supreme Court, the Chancery Court's language offers a far more pro-investor approach: "Aggrieved stockholders of Delaware corporations ought to be able to expect that an impartial tribunal, and not a committee appointed by the alleged wrongdoers, will decide whether a stockholder's derivative suit alleging breach of fiduciary duty has any merit." Maldonado v. Flynn, 413 A.2d 1251, 1263 (Del. Ch. 1980).

88. See cases cited supra notes 81–82. As the business judgment rule insulates a subject corporate board's decisions from successful challenge unless a disabling conflict of interest or gross negligence is shown, directors may act with ordinary negligence and be entitled to invoke the rule. See Aronson v. Lewis, 473 A.2d 805, 872 (Del. 1984).

89. See, e.g., Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496 (1900); Broz v. Cellular Info. Sys., 673 A.2d 148, 155 (Del. 1996) ("A corporate fiduciary agrees to place the interests of the corporation before his or her own in appropriate circumstances."); Ne. Harbor Golf Club, Inc. v. Harris, 725 A.2d 1018 (Me. 1999) (affirming that directors and officers cannot "secure a private advantage at the expense of the corporation"); Miller v. Miller, 222 N.W.2d 71, 78 (Minn. 1974) ("[T]he doctrine of corporate opportunity[] is derived essentially from fundamental rules of agency concerning the duty of utmost good faith and loyalty owed by a fiduciary to his principal."); Today Holmes, Inc. v. Williams, 634 S.E.2d 737 (Va. 2006); Fletcher, supra note 1, § 861.10.

90. See infra notes 91–93 and accompanying text.

91. Generally, this test focuses on whether the subject company has expressed an interest in the particular opportunity that the officer or director takes for herself. See, e.g., Farber v. Servan Land Co., 662 F.2d 371, 377 (5th Cir. 1981) (applying Florida law). The traditional view of the interest or expectancy test was enunciated by the Alabama Supreme Court in Lagarde v. Anniston Lime & Stone Co., 28 So. 199, 201 (Ala. 1899) (deeming a corporate opportunity "property wherein the corporation has an interest already existing or in which it has an expectancy growing out of an existing right").

92. The line-of-business test focuses on opportunities that are in the same or closely related line of business. Depending on the facts and circumstances, this test also encompasses a company's prospective plans so long as such plans are sufficiently concrete. See, e.g., Broz, 673 A.2d at 185 ("[W]hether or not a director has appropriated for himself something that in fairness should belong to the corporation [is] to be decided by reasonable inference from objective facts."); PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 8 (Minn. 1990) (stating that when a business opportunity presents itself to a director, that opportunity belongs to the corporation if it is within the corporation's interest or expectant interest); Ellsey v. Fyr Pruf, Inc., 376 So. 2d 1328, 1333 (Miss. 1979) (same).

93. The fairness test addresses whether the subject transaction was a corporate opportunity, either under the interest or expectancy test or the line of business test. If deemed a corporate opportunity, the court then conducts a fairness inquiry assessing such criteria as whether the officer or director: learned of the opportunity in his official or personal capacity; is an inside or outside director; used corporate property or other corporate resources to find the opportunity; and whether the company had the financial wherewithal to undertake the opportunity. See, e.g., Miller v. Miller, 222 N.W.2d 71 (Minn. 1974). The American Law Institute has adopted a different standard. See PRINCIPLES OF CORP. GOVERNANCE, supra note 43, § 5.05. This test has been adopted by a number of states, including Maine. See Harris, 725 A.2d at 1022; infra notes 95–98 and accompanying text.
taking of an opportunity that would have been beneficial to the corporation, thereby adversely impacting such corporation. Therefore, in this setting, the fiduciary is benefiting at the corporation’s expense.  

The corporate opportunity test adopted by the American Law Institute (ALI) illustrates this detrimental impact. Under the ALI standards, so long as an outside director is not engaged in the performance of her functions as a director, not utilizing corporate resources to access the opportunity, and such opportunity is not presented to her with the understanding that it be offered to the corporation, the outside director may permissibly acquire the opportunity even though it is in such corporation’s line of business or closely related thereto. Hence, in this situation, the outside director, a fiduciary of the corporation, can take an opportunity for her own financial benefit to the exclusion of—and detriment to—the corporation for whom she serves. In plain English, the corporate director financially benefits at the corporation's expense. This exploitation of what would otherwise be an opportunity properly belonging to the subject corporation by an outside director provides a clear illustration of the distinction between rhetoric and reality in the corporate law setting.

The above situations illustrate the obfuscation of fiduciary duty analysis in the duty

94. Generally, a corporate opportunity may be taken by an officer or director only after making adequate disclosure to the board of directors, and the independent members of the board (or a committee comprised of independent directors) reject the opportunity. As a conflict of interest transaction, when an inside director or executive officer is to profit from the opportunity, independent directors often play a decisive role. See MBCA § 8.70(a)(1)(i). Where a director or officer wrongfully seizes a corporate opportunity, a constructive trust may be ordered, requiring the fiduciary to transfer the asset (e.g., real property) to the corporation. See, e.g., Brandt v. Somerville, 692 N.E.2d 144 (N.D. 2005).

95. Generally, an outside director is an individual who has no employment or other significant relationship with the corporation. The New York Stock Exchange defines a director as not being independent when such person is or has been: “an employee or executive of the listed company within the past three years;” “directly compensated (other than receipt of director and committee fees or payment of deferred compensation based on prior service) more than $120,000 by the listed company within any twelve-month period during the last three years;” “a current employee or partner of the listed company’s internal or external auditor;” “an executive officer within the past three years of another company where any of the listed company’s current executive officers ‘serves or served’ on such other company’s compensation committee;” and “a current employee of an enterprise that within any of the past three fiscal years ‘has made payments to, or received payments from the listed company for property or services,’ provided such amount ‘exceeds the greater of $1 million, or 2% of such other [enterprise’s] consolidated gross revenues.’” STEINBERG, FEDERALIZATION OF CORPORATE GOVERNANCE, supra note 10, at 235 (citing NEW YORK STOCK EXCHANGE (NYSE) MANUAL § 303A.02(b)). These rules also apply to the subject director’s immediate family members. See NYSE MANUAL § 303A.02.

96. See PRINCIPLES OF CORP. GOVERNANCE, supra note 43, § 5.05(b)(2) (defining a corporate opportunity to include, inter alia, “[a]ny opportunity to engage in a business activity of which a senior executive [hence, excluding an outside director] becomes aware and knows is closely related to a business in which the corporation is engaged or expects to engage”).

97. See supra notes 93, 96. Cf. Burg v. Horn, 380 F.2d 897 (2d Cir. 1967) (applying New York law) (holding that inside director properly took corporate opportunity because he had several other real estate ventures investing in similar endeavors).

98. Practicalities must be assessed in allowing an outside director under such circumstances to take a corporate opportunity for herself. A strict approach dissuades successful businesspersons from serving as outside directors on corporate boards. Being involved in several other ventures, many qualified individuals would decline to serve on corporate boards due to this restraint. Providing a flexible standard in this setting thus, at least theoretically, enables companies to recruit sought-after prospective outside directors. See PRINCIPLES OF CORP. GOVERNANCE, supra note 43, § 5.05; id. § 5.05(b) cmt.
of loyalty context. Self-dealing activities engaged in by fiduciaries frequently are given
refuge in the corporate law setting.\textsuperscript{99} Ordinarily, this conduct is protected under the
umbrella of the business judgment rule.\textsuperscript{100} In other situations, more accommodating legal
principles are developed, such as with respect to an outside director who takes a business
opportunity that otherwise would properly belong to the subject corporation.\textsuperscript{101} The end
result is the minimization of fiduciary duty principles in this setting.

5. Fiduciary Duties of Controlling Shareholders

Like corporate directors and officers, controlling shareholders owe fiduciary duties to
the subject corporation and its minority shareholders.\textsuperscript{102} In many typical scenarios, the
controlling shareholder is a publicly-held corporation that owns a majority of the common
stock in a publicly-traded subsidiary.\textsuperscript{103} By means of its stock ownership, the controlling
shareholder can elect all of the subsidiary's directors and vote its stock at shareholder
meetings to carry out its agenda. Through these means, the controlling shareholder can
effectuate its own best interests to the detriment of the subsidiary corporation and its
minority shareholders.\textsuperscript{104}

Recognizing the leverage that controlling shareholders enjoy, courts have placed
limitations on their actions.\textsuperscript{105} One such example arises in the parent-subsidiary merger
setting. In that setting, the Delaware Supreme Court applies the entire fairness standard
whereby the inquiry focuses on fair price and fair dealing.\textsuperscript{106} Nonetheless, when a special
negotiation committee comprised of independent directors of the subsidiary corporation
meaningfully bargains with the parent company and the minority shareholders of the
subsidiary corporation approve the transaction having adequate disclosure, the business
judgment rule is the applicable standard.\textsuperscript{107}

\textsuperscript{99} See discussion supra notes 31–98 and accompanying text.

\textsuperscript{100} See, e.g., discussion supra notes 51–60, 73–76, 82–88 and accompanying text.

\textsuperscript{101} See discussion supra notes 89–98 and accompanying text.

\textsuperscript{102} See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 711–14 (Del. 1983) (addressing fiduciary duties
owed by the parent corporation to its subsidiary and to the shareholders of the subsidiary); Sinclair Oil Corp. v.
Levien, 280 A.2d 717, 720 (Del. 1971) (stating that “[a] parent does indeed owe a fiduciary duty to its subsidiary
when there are parent subsidiary dealings”).

\textsuperscript{103} The cash-out merger transaction involving a parent corporation and its publicly-traded subsidiary has
given rise to much case law on this subject. See, e.g., Weinberger, 457 A.2d at 701 (cash-out merger involving
the parent and its majority-owned publicly-traded subsidiary); sources cited infra notes 104–22.

\textsuperscript{104} In Sinclair Oil, the Delaware Supreme Court held that self-dealing giving rise to the intrinsic fairness
test arises in the parent-subsidiary setting “when the parent, by virtue of its domination of the subsidiary, causes
the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of,
and detriment to, the minority stockholders of the subsidiary.” 280 A.2d at 720–23.

\textsuperscript{105} Notably, outside Delaware, a number of courts hold that absent deficient disclosure, fraud, or illegality,
appraisal is a minority shareholder’s exclusive remedy in a cash-out merger. See, e.g., Yanow v. Teal Indus., Inc.,
422 A.2d 311 (Conn. 1979); Stepak v. Schey, 533 N.E. 2d 1072 (Ohio 1990); Sound Infiniti, Inc. v. Snyder, 237
P.3d 241 (Wash. 2010); see also MINN. STAT. ANN. § 302A.601 cmt.3 (providing that “[t]he remedy for lack of
‘entire fairness’ in the transaction in this act is the appraisal section . . . .”).

\textsuperscript{106} See Weinberger, 457 A.2d at 711 (stating that “[t]he concept of fairness has two basic aspects: fair
dealing and fair price” in a cash-out merger transaction); Alpert v. 28 Williams St. Corp., 473 N.E. 2d 19 (N.Y.
1984) (adhering to entire fairness standard in a cash-out merger transaction).

\textsuperscript{107} See Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014); In re Kenneth Cole Prods., Inc.
In this context, the business judgment rule makes good sense. The good faith and tenacious bargaining of a special negotiation committee comprised of independent directors, advised by independent investment bankers and legal counsel, with the wherewithal to “say no” to the contemplated merger, simulates arms-length dealing between parties having relatively equal leverage.\(^{108}\) The added protection of an informed majority of the minority vote of the subsidiary’s unaffiliated shareholders as a necessary condition to invoke the business judgment rule provides an additional substantive degree of protection from the majority’s overreaching.\(^{109}\) When faithfully applied, these minority shareholder protective measures are more congruent with the standards by which fiduciary conduct should be measured.\(^{110}\)

Nonetheless, in many states, absent fraud or illegality, appraisal is a minority shareholder’s exclusive remedy in the parent-subsidiary merger setting.\(^{111}\) Indeed, this standard applies in Delaware with respect to short-form mergers.\(^{112}\) In theory, the appraisal process provides fair value to the minority shareholder for her stock.\(^{113}\) In actuality, as has long been recognized, this remedy has been coined as one of “desperation,”\(^{114}\) with its

\(^{108}\) S’holder Litig., 52 N.E.3d 214 (N.Y. 2016). In a subsequent Delaware Supreme Court decision, the court held that in order for the business judgment rule to apply in this setting:

[A] controller is required to condition the buyout on both the approval of an independent, fully empowered Special Committee and the approval of a majority of the minority stockholders at the beginning stages of the process of considering a going-private proposal and before any negotiations commence between the Special Committee and the controller over the economic terms of the offer. Flood v. Synutra Int’l, Inc., 195 A.3d 754, 763–64 (Del. 2018). Also, in short-form cash-out mergers where the parent corporation owns 90% or more of the subsidiary’s stock, the Delaware Supreme Court has held that absent fraud or illegality, appraisal is the minority shareholder’s sole remedy. See Glassman v. Unocal Expl. Corp., 777 A.2d 242 (Del. 2001); Marc I. Steinberg, Short-Form Mergers in Delaware, 27 Del. J. Corp. L. 489, 489 (2002). The application of this standard in short-form mergers resembles that of the business judgment rule.

\(^{109}\) See id. at 645 (stating, among other requirements for the business judgment rule to apply in such cash-out merger transactions, that the Special Committee, comprised of independent directors, “is empowered to freely select its own advisors and to say no definitively”).

\(^{110}\) See id. at 644 (stating that “business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned ab initio upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders”).

\(^{111}\) The same analysis applies with respect to the use of a tender offer in a cash-out transaction sought by a majority stockholder. See In re CNX Gas Corp. S’holders Litig., 4 A.3d 397, 413 (Del. Ch. 2010) (stating that “if a first-step tender offer is both (i) negotiated and recommended by a special committee of independent directors and (ii) conditioned on the affirmative tender of a majority of the minority shares, then the business judgment standard of review presumptively applies to the freeze-out transaction”).

\(^{112}\) See supra note 105 and accompanying text.

\(^{113}\) See Glassman, 777 A.2d 242. In a short-form merger, the parent corporation owns at least 90% of its subsidiary’s common stock. See Del. Gen. Corp. L. § 253 (West 2020). Nonetheless, disclosure obligations prevail in the short-form merger setting. See Glassman, 777 A.2d at 248 (“Although fiduciaries are not required to establish entire fairness in a short-form merger, the duty of full disclosure remains . . . .”).

\(^{114}\) Glassman, 777 A.2d at 248 (“The determination of fair value must be based on all relevant factors, including damages and elements of future value, where appropriate . . . [and] if the merger was timed to take advantage of a depressed market, or a low point in the company’s cyclical earnings, or to precede an anticipated positive development, the appraised value may be adjusted to account for those factors.” (emphasis in original)).
numerous technical hurdles for a shareholder to overcome.115 In practice, therefore, in many parent-subsidiary merger transactions, the legal analysis is devoid of fiduciary conduct scrutiny. Rather, so long as neither fraud nor illegality is perpetrated, the majority can relegate the minority to a remedy that is frequently ineffectual.116

Perhaps the most telling signal that fiduciary duty standards are slighted in this context arises in the determination of the appropriate legal standard to be applied. In related party transactions between the parent corporation and its subsidiary, the intrinsic fairness test applies only when there is self-dealing engaged in by the parent company.117 Defining this term narrowly, the Delaware Supreme Court held that self-dealing exists when the parent corporation, through its domination of the subsidiary, causes the subsidiary to bestow a benefit upon the parent “to the exclusion of, and detriment to the minority stockholders of the subsidiary.”118

In that case, the parent company, owning 97% of its subsidiary’s stock, caused the subsidiary to declare a distribution of $108 million that, in practical effect, was a partial liquidation of the subsidiary. The effect of the distribution was to enable the parent corporation to have access to much needed cash while the subsidiary’s potential growth was stymied.119 Because the minority shareholders received their pro rata share of the distribution, the court ruled there was no self-dealing and that, accordingly, the business judgment rule was the governing standard.120 With the Delaware Supreme Court’s approbation, a controlling shareholder accordingly can effectuate a recapitalization principally for its own financial benefit, thereby precluding the minority shareholders from

115. See Randall Thomas, Revising the Delaware Appraisal Statute, 3 Del. L. Rev. 1, 30 (2000) (stating that the appraisal remedy is “procedurally complex” with “several strict deadlines that a shareholder must satisfy in order to perfect her appraisal right” having the consequence that the “procedural requirements seem quite burdensome on smaller shareholders”).

116. See Pink v. Cambridge Acquisition, Inc., 727 A.2d 414, 419–20 (Md. Ct. Spec. App. 1999) (requiring strict compliance with requirements of the appraisal statute in order for a dissenting shareholder to invoke the remedy); Stauffer v. Standard Brands, Inc., 187 A.2d 78 (Del. 1962) (denying shareholder relief where there was a failure to perfect the appraisal remedy where such remedy was exclusive); MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 15.03[3] (2021) (stating that “an aggrieved minority shareholder ordinarily will be left with no other recourse but to reluctantly agree to the price offered or to invoke the appraisal remedy [but] the procedural requirements and financial costs of the appraisal statute will impose a substantial hardship on such minority shareholder plaintiffs”); Bayless Manning, The Shareholders’ Appraisal Remedy: An Essay for Frank Coker, 72 Yale L.J. 223, 230 (1962) (commenting that “the general tendency in the corporate field [is] to center within management all significant operational control and to relegate the shareholder’s claim of ‘ownership’ to the status of the fungible dollar claim”); Mary Siegel, Back to the Future: Appraisal Rights in the Twenty-First Century, 32 Harv. J. on Legis. 79, 79–80 (1995) (stating that the appraisal “remedy has long been viewed as useless except to shareholders with a large number of shares”).

117. See, e.g., Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (holding that the intrinsic fairness standard applies only when there is self-dealing and that “occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary”).

118. Id. (stating also that “[t]his standard will be applied only when the fiduciary duty is accompanied by self-dealing—the situation when a parent is on both sides of a transaction with its subsidiary”).

119. Id. at 721–22 (observing that Sinclair caused these distributions to be paid during a time when it had the need for large amounts of cash).

120. Id. (stating that although “[t]he dividends resulted in great sums of money being transferred from Sinven to Sinclair . . . a proportionate share of the money was received by minority shareholders of Sinven,” and that, hence, “Sinclair received nothing from Sinven to the exclusion of its minority stockholders”).
future economic benefits that otherwise would be derived, with the permissive business
djudgment rule ordinarily being applied. So long as the minority shareholders received their
pro rata amount, no self-dealing is deemed to have occurred. Such an approach—namely,
the application of the business judgment rule in this parent-subsidiary recapitalization
scenario—is inconsistent with standards of fiduciary conduct. With the fiduciary arranging,
participating, and consummating a financial transaction with the motivation to enhance its
own economic condition, the entire fairness standard should be the governing standard.\textsuperscript{121}

Thus, the rhetoric of vibrant fiduciary standards versus the actuality of its
implementation likewise is manifested in the treatment of controlling shareholders. Although judicial assertions are made as to the presence of rigorous fiduciary standards,
permissive application is standard fare. The consequence is the legitimacy of controller
conduct being upheld under the business judgment rule when transactions are motivated
and consummated with the objective of furthering such controller’s financial condition. In
many of these transactions, minority shareholders are worse off but have minimal recourse.
In realistic terms, this framework is antithetical to the recognition of meaningful fiduciary
standards.\textsuperscript{122}

6. The Close Corporation Fallacy

One key situation where fiduciary duties are rigorously applied in several jurisdictions
is in the closely-held corporation setting.\textsuperscript{123} In this setting, shareholders, particularly

\textsuperscript{121} There is no question that a partial liquidation was affected by the payment of the $108 million dividend.
See id. at 720–21 (acknowledging that the dividends paid exceeded earnings). A second part of the case dealt with
Sinclair’s failure to effect compliance with the terms of a contract that it had one of its other subsidiaries enter
into with Sinven. Because this transaction constituted self-dealing, Sinclair, as the controlling shareholder, had
the burden of proving that the effectuation of the contract was intrinsically fair to Sinven. Id. at 722–23. In certain
situations, recapitalizations under Delaware law trigger an entire fairness review. In this context, when a
controlling shareholder receives a unique benefit by extracting an advantage that is peculiarly valuable to such a
shareholder, the entire fairness test is the applicable standard, even where the controlling shareholder’s
consideration is the same as all other shareholders. See IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742, 2017
WL 7053964, at *9 (Del. Ch. Jan. 26, 2018) (holding entire fairness review appropriate where low-vote stock was
issued to all shareholders for the purpose of enhancing the controlling shareholder’s voting power).

\textsuperscript{122} See supra notes 111–21 and accompanying text.

\textsuperscript{123} Generally, a closely held corporation is viewed as having few shareholders, no liquid trading market to
dispose of one’s stock, and substantial shareholder participation in the company’s operation and management. It
is common for shareholders to derive their livelihood from their employment with the corporation. See Donahue
v. Rodd Electrotype Co. of New England, 328 N.E.2d 505, 509 11 (Mass. 1975). Several states have enacted
statutes conferring close corporation status that provide greater flexibility and informaltry in matters of corporate
governance. See, e.g., DEL. GEN. CORP. L. §§ 341–56. These statutes have not been frequently utilized. In
recognition of the lack of utilization of these statutes, the Model Act expressly authorizes the use of unanimous
shareholder agreements that permit shareholders in a closely held corporation to dispense with otherwise
mandatory corporate norms, including eliminating the company’s board of directors. See MODEL BUS. CORP. ACT
§ 7.32 (2021). This provision of the Model Act has been adopted by many states. See, e.g., Fla. Stat. Ann. §
controllers.\textsuperscript{124} are held to owe their fellow shareholders a strict duty of loyalty.\textsuperscript{125} This
overriding concept has been applied to actions taken by controlling shareholders that deny
the minority participants their alleged entitlement to employment, salaries, dividends, and
director and officer positions.\textsuperscript{126} Alleged self-dealing by controlling shareholders is
vigorously scrutinized, particularly when their increased salaries in fact may be disguised
dividends.\textsuperscript{127} When a course of conduct has been perpetrated that deprives minority
shareholders of their reasonable expectations, several courts have held that a buy-out of the
minority's shares at fair value is an appropriate remedy.\textsuperscript{128}

When applying these fiduciary standards, courts analogize the close corporation to a
partnership, where fiduciary duties traditionally have been owed among the partners.\textsuperscript{129}
Viewing these corporations as "incorporated partnerships," a strict duty of loyalty is
recognized between controlling shareholders and the minority who claim they have been
subject to improper treatment.\textsuperscript{130} Yet, a great irony abounds with respect to this analogy.
In the days of yesteryear, partners indeed owed, as a matter of course, strict fiduciary duties

\begin{itemize}
\item 124. Controllers may consist of several shareholders, each owning a minority interest, who join together as
1976).
\item 125. \textit{Donahue}, 328 N.E.2d at 516; see also \textit{Rexford Rand Corp. v. Ancel}, 58 F.3d 1215, 1218–19 (7th Cir.
1995) (applying Illinois law) ("Under Illinois law, a shareholder in a close corporation owes a duty of loyalty to
the corporation and to the other shareholders."); \textit{Demoulas v. Demoulas Super Mkts.}, Inc., 677 N.E.2d 159, 179
(Mass. 1997) (Regarding close corporations, "duties of loyalty extend to shareholders, who owe one another
substantially the same duty of utmost good faith and loyalty in the operation of the enterprise that partners owe
to one another, a duty that is even stricter than that required of directors and shareholders in corporations
generally"); \textit{Fletcher}, supra note 1, § 844.20 ("Close corporation shareholders ... stand in fiduciary
relationship to each other.").
\item 126. See cases supra notes 123–25. In this respect, the shareholder oppression doctrine is widely recognized,
requiring a corporation or its controlling shareholders to purchase the oppressed shareholder's stock at fair value
in lieu of dissolving and liquidating the subject company. See, e.g., \textit{Guge v. Kassel Enters.}, Inc., 962 N.W.2d 764,
768 (Iowa 2021) (stating that "in lieu of defending a dissolution proceeding, the law allows the corporation to
force the complaining shareholders to sell their stock for the 'fair value'"); \textit{In re Kemp & Beatley}, Inc., 473
443 S.W. 3d 856, 892 (Tex. 2014) (rejecting minority shareholder oppression doctrine).
\item 127. See, e.g., \textit{Kemp & Beatley}, 473 N.E.2d at 1180–81; \textit{Wilkes}, 353 N.E.2d at 662–64; \textit{Wilderman v.
\item 128. See, e.g., \textit{Baur v. Baur Farms, Inc.}, 832 N.W.2d 663, 677–78 (Iowa 2013); \textit{Lund v. Revocable
A number of courts have adopted the "reasonable expectations" test in determining the existence of
shareholder oppression. That standard looks to "[t]he reasonable expectations of the shareholders, as they exist at
the inception of the enterprise." But, in order for such expectations to be reasonable, "they must be known by or
assumed by the other shareholders and concurred in by them." \textit{Meiselman}, 307 S.E.2d at 563. A second definition
of oppressive conduct focuses on "burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in
the affairs of a company to the prejudice of some of its members; or a visible departure from the standards of fair
dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled
to rely ...." \textit{Gimpel v. Bostein}, 477 N.Y.S.2d 1014, 1018 (N.Y. Sup. Ct. 1984); see generally \textit{F. Hodge O'Neal &
Robert B. Thompson, O'Neal and Thompson's Close Corporations and LLCs: Law and Practice §§
9.37–9.38 (rev’d, 3d ed. 2021); Douglas K. Moll, Shareholder Oppression and "Fair Value": Of Discounts,
Dates, and Dastardly Deeds in the Close Corporation, 54 Duke L.J. 293, 310 (2004); Robert B. Thompson, The
\item 129. See, e.g., \textit{Meiselman}, 307 S.E.2d at 557; \textit{Wilkes}, 353 N.E.2d at 661; \textit{Donahue}, 328 N.E.2d at 516;
\item 130. See supra notes 124–26 and accompanying text.
\end{itemize}
to one another. But that clearly is not the situation today. As addressed earlier in this Article, fiduciary duties have been significantly diminished in the partnership setting. Indeed, the duty of care is no longer treated as a fiduciary duty. Moreover, by contractual agreement among the partners, unless "manifestly unreasonable," the partnership agreement can eliminate "aspects of the duty of loyalty." To liken the relations among the shareholders of a closely-held corporation to those of partners today to justify the application of strict concepts of fiduciary duty is to engage in a fictional exercise. Similar to corporation law, fiduciary standards in the partnership law setting have been diluted. Hence, a fallacy prevails in several jurisdictions in the close corporation setting to justify the recognition of vibrant fiduciary standards. Although applying these standards may be equitable in specified circumstances, the reliance on partnership law is misplaced.

7. Summation

The preceding discussion aptly illustrates the glaring gap between rhetoric and reality with respect to the application of fiduciary standards in the corporate law setting. While exhortatory generalizations extolling the virtues of rigorous fiduciary standards are made with regularity by courts, the application of these standards to alleged insider misconduct lacks substantive consistency. Irrespective of the flowery language used by courts lauding the perceived presence of meaningful fiduciary standards in this setting, reality conveys a starkly different impression. With frequency, lax standards apply to insider conduct, rendering corporate directors and officers as fiduciaries in name only. As addressed in the following discussion, this phenomenon with respect to insiders also exists with respect to situational aspects of the federal securities laws.

C. Fiduciary Duty Application in the Securities Law Setting

The federal securities laws are premised on concepts of disclosure rather than substantive fairness. With exceptions, provided that adequate disclosure is made to

131. See, e.g., Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928); supra notes 15-17 and accompanying text.
132. See supra notes 19-26 and accompanying text.
133. See UNIF. P'SHIP ACT § 409(c); UNIF. LTD. P'SHIP ACT § 409(c); supra notes 20-21 and accompanying text.
134. See UNIF. P'SHIP ACT § 105(d)(3)(A)-(B); discussion supra notes 22. 26 and accompanying text.
135. A key rationale underlying the strict duty of loyalty in close corporations is that, absent a court order requiring that the minority shareholder’s stock be purchased at fair value, such shareholder has no advantageous exit route from the corporation unless a shareholder agreement provides that remedy or the controlling shareholders agree. The likely consequence is that the controller seeks to purchase the minority’s stock at a bargain price, if at all. See, e.g., Wilkes, 353 N.E.2d at 664 n.14; Fought v. Morris, 543 So.2d 167, 171-72 (Miss. 1989); Walta v. Gallegos Law Firm, P.C., 40 P.3d 449, 459 (N.M. Ct. App. 2001). By contrast, a general partner always has the power to exit the partnership, even if such conduct is wrongful and in breach of the partnership agreement. See UNIF. P'SHIP ACT § 602(a) ("A partner has the power to disassociate as a partner at any time, rightfully or wrongfully, by withdrawing as a partner by express will . . . .").
136. See, e.g., Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477-78 (1977) (stating that the Supreme Court "repeatedly has described the "fundamental purpose" of the [Securities Exchange] Act as implementing a 'philosophy of full disclosure'").
137. For example, pursuant to the Sarbanes-Oxley Act of 2002 (SOX), with specified exceptions, a publicly-held company is prohibited from making loans to its directors and executive officers. See SOX § 402 (adding Section 13(k) of the Securities Exchange Act).
the securities markets and investors, the fairness of a transaction is a matter of tangential concern under the federal securities laws.\textsuperscript{138} Focusing on disclosure, a primary objective of the federal securities laws is to mandate the dissemination of adequate information so that informed decision-making in the investment and voting contexts can be made.\textsuperscript{139}

Nonetheless, insider fiduciary duty obligations have relevance to disclosure obligations. The ensuing discussion addresses these obligations under two different provisions of the federal securities laws: Section 11 of the Securities Act\textsuperscript{140} and Section 10(b) of the Securities Exchange Act.\textsuperscript{141} Similar to state corporation law, a significant gap exists between rhetoric and reality in the federal securities law setting.

1. Application of Fiduciary Standards under Securities Act Section 11

Section 11 of the Securities Act provides an express right of action for aggrieved investors who purchased their securities pursuant to a registration statement that contained defective disclosure.\textsuperscript{142} When a registration statement contains a material misrepresentation or omission,\textsuperscript{143} a plaintiff may sue specified persons for damages under Section 11, including the subject corporation’s directors and certain high-level officers.\textsuperscript{144} These individual defendants may avoid liability by successfully asserting their due

\textsuperscript{138}. See, e.g., Santa Fe, 430 U.S. at 477–78. Nonetheless, with some frequency, the SEC seeks to impact substantive fiduciary conduct through the guise of disclosure. This approach was advanced by the Commission over fifty years ago. See In re Franchard Corp., 42 S.E.C. 163, 172 (1964) (holding that disclosure of management self-dealing was material to investors, reasoning that such disclosure was “germane to an evaluation of the integrity of management”). For further discussion, see Steinberg, supra note 10, at 133–36; Ralph C. Ferrara, Richard M. Starr & Marc I. Steinberg, Disclosure of Information Bearing on Management Integrity and Competency, 65 NW. U. L. REV. 555 (1981).

\textsuperscript{139}. See Mills v. Elec. Auto-Lite Co., 396 U.S. 375 (1980); see also Santa Fe Indus., 430 U.S. at 477–78.

\textsuperscript{140}. 15 U.S.C. § 77k. Pursuant to its rulemaking authority under Section 10(b), the SEC adopted Rule 10b-5, a key antifraud provision. See 17 C.F.R. § 240.10b-5 (2011). As stated by Justice Rehnquist in Blue Chip Stamps v. Manor Drug Stores, “[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.” 421 U.S. 723, 737 (1975). For the seminal treatise on Rule 10b-5, see Alan R. Bromberg et al., Bromberg and Lowenfels on Securities Fraud (2021).


\textsuperscript{142}. The misstatement or omission must be material to be actionable. Stated succinctly, an omitted or misstated fact “is material if there is a substantial likelihood that a reasonable shareholder would consider [the information if accurately disclosed] important in deciding how to vote [or in making an investment decision].” TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). Hence, there must be “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011) (quoting Basic Inc. v. Levinson, 485 U.S. 224, 221–32 (1988)). Regarding contingent events, such as a merger or acquisition, materiality “will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.” Basic Inc., 485 U.S. at 238 (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

\textsuperscript{143}. These high-level officers include the subject company’s chief executive officer, chief financial officer, and controller. These individuals are subject to Section 11 liability exposure because they are signatories of the registration statement. See Securities Act of 1933 § 6(a), 15 U.S.C. § 77(a). In addition to directors and specified executive officers, other potential Section 11 defendants include the company itself, the underwriters, and experts (such as the auditor who certifies the company’s financial statements). See Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a).
The due diligence defense.\textsuperscript{145} Stated generally, assuming that a material misstatement or omission was made in a registration statement, a subject director or officer can avert liability by proving that she had conducted a reasonable investigation and had reasonable ground to believe that the registration statement was accurate.\textsuperscript{146} The statute defines that the standard of reasonableness with respect to such defendant’s investigation and belief is that “required of a prudent man in the management of his own property.”\textsuperscript{147} This standard, derived from trust law,\textsuperscript{148} was set forth in that context nearly two hundred years ago when the Massachusetts high court directed that a trustee act “faithfully and exercise a sound discretion... observing how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”\textsuperscript{149}

This “prudent man” standard under Section 11 was applied faithfully in the seminal BarChris decision, where the court held that the subject directors and officers did not meet their due diligence defense.\textsuperscript{150} For over fifty years, the BarChris analysis has been followed by the federal courts.\textsuperscript{151} Nonetheless, the standard has been relaxed to some extent for certain defendants subject to Section 11 liability, particularly for underwriters in the shelf registration setting.\textsuperscript{152} To a lesser degree, outside directors also have enjoyed a less

\textsuperscript{145} The due diligence defense is set forth in Section 11(b)(3). With respect to statements contained or omitted in a registration statement (other than those made by an expert), non-experts (such as directors and executive officers) must prove that they conducted a reasonable investigation and, after such investigation, reasonably believed that the registration statement did not contain a material misstatement or omission. This standard also applies to experts with respect to those portions of the registration statement that a subject expert has “expertized.” The issuer has no due diligence defense. For further discussion, see MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 230–42 (7th ed. 2018).

\textsuperscript{146} The statement in the text focuses on statements contained in the registration statement that are not made by an expert. With respect to statements made by an expert, a non-expert (including a director or executive officer) in order to establish the due diligence defense is not required to conduct a reasonable investigation; rather, such individual need only show that she reasonably believed that the expertise statements were accurate. See Securities Act of 1933 § 11(b)(3).

\textsuperscript{147} See Securities Act of 1933 § 11(c) (“In determining, for the purpose of [the due diligence defense under this statute], what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.”).


\textsuperscript{149} Harvard Coll. v. Amory, 26 Mass. (9 Pick.) 446, 461 (1830).


\textsuperscript{152} See, e.g., Rule 176(h), 17 C.F.R. § 230.176(h) (In determining whether an underwriter has conducted a reasonable investigation or a reasonable ground for belief, a relevant criterion is whether the underwriter, “with respect to a fact or document incorporated by reference, . . . had any responsibility for the fact or document at the time of the filing from which it was incorporated.”). Generally, shelf registration permits an issuer to register securities without being required to sell at that time the entire number of shares that are registered. Rather, the
stringent burden to satisfy their due diligence defense. In this regard, an outside director ordinarily need not conduct a thorough independent investigation. Rather, provided she does not have actual or constructive notice of a material disclosure deficiency in the registration statement, attends board of director meetings at which a draft (or drafts) of the registration statement (and documents incorporated by reference therein) are adequately addressed, has sound confidence in the procedures and competence of the subject board committees that review the company’s periodic SEC filings, reviews the registration statement (or drafts thereof) and the documents incorporated by reference therein with care, probes company personnel, legal counsel, and other suitable persons (including outside advisers) seeking explanation, and follows up if appropriate, the due diligence defense ordinarily will be deemed to have been met.153 Because outside directors can largely satisfy this defense by relying in good faith on internal personnel and other agents of the corporation, it may be asserted that requisite independent investigation is absent.154 To alleviate this concern, a requirement that a publicly-traded corporation, as a condition of having its stock listed on a national securities exchange, would be required to have a disclosure committee composed entirely of independent directors would serve as a useful mechanism for satisfying a more robust due diligence presence.155 The committee, retaining its own legal counsel, would engage in ongoing due diligence to help ensure the adequacy of disclosure for the subject company’s registration statements and other SEC filings.156

Nonetheless, the due diligence defense under Section 11 retains its vitality. Although


153. See, e.g., Weinberger, 1990 WL 260676, at *3; STEINBERG, supra note 145, at 231–32.

154. This approach may not be practical in some situations in view of the challenges faced by outside directors to conduct an independent investigation. Nonetheless, a key ingredient of the due diligence function—verification—is essential to instill greater discipline in this process. The presence and efficient operation of a disclosure committee comprised of independent directors would be instrumental in enhancing the due diligence function. See infra notes 156–57 and accompanying text.


156. See SEC Advisory Committee, supra note 155, at 427–28 (stating that the effective functioning of a disclosure committee comprised solely of outside directors would help “ensure more continuous oversight of the disclosure preparation process, and . . . provide a focus at the board level for due diligence in the context of primary offerings by issuers, thereby ensuring greater involvement by outside directors as one set of monitors”); MARC I. STEINBERG, supra note 56, at 114 (asserting that effective implementation of a disclosure committee comprised entirely of outside directors “would enable [such] outside directors to perform ongoing due diligence in a proactive manner . . . [and enable them] to take greater control of the disclosure function”).
not as vibrant in the shelf registration setting, the fiduciary standard contained in the statute continues with some vigor, inducing prudent directors and officers to engage in meaningful due diligence practices.\textsuperscript{157} Another more recent development, however, has significantly weakened the stringent standards set forth in Section 11. With respect to statements of belief or opinion expressed in a registration statement, the Supreme Court has held that such statements are actionable only if the defendant, in fact, knew that they were untrue.\textsuperscript{158} Liability also may arise under Section 11 based on a material omission concerning a defendant’s knowledge of or inquiry into a statement of opinion or belief if the facts “conflict with what a reasonable investor would take from the statement itself . . . .”\textsuperscript{159} By differentiating statements of belief or opinion from factual statements that are subject to “complete demonstration,”\textsuperscript{160} the Court leaves investors without a federal remedy when statements of belief or opinion are made without a reasonable basis in Securities Act registration statements.\textsuperscript{161} Its holding thus incentivizes companies and their insiders to engage in unwarranted optimistic statements of opinion or belief to facilitate the successful consummation of a registered offering.\textsuperscript{162} Such an approach is antithetical to the fiduciary-like standards embodied in Section 11. Executive officers and directors who carelessly orchestrate such false optimistic statements of belief or opinion in their company’s registration statements are unduly insulated from investor liability. This approach, accordingly, is incompatible with their fiduciary obligations.\textsuperscript{163}


\textsuperscript{158} See \textit{Omnicare}, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 184 (2015) (opining that “every statement [of opinion] explicitly affirms one fact: that the speaker actually holds the stated belief”). With respect to an embedded statement of fact, namely, a statement of belief or an opinion that is based on an underlying fact, liability may ensue under Section 11 when the speaker knowingly communicates a false supporting fact. See \textit{id.} at 185. The rationale of \textit{Omnicare} has been extended to Section 10(b) of the Exchange Act. See, e.g., Dearborn Heights v. Align Tech., Inc., 856 F.3d 605, 616 (9th Cir. 2017).

\textsuperscript{159} See \textit{Omnicare}, 575 U.S. at 187–94. Or, stated somewhat differently, when a plaintiff invokes a theory of omission with respect to a statement of belief or opinion, the plaintiff must adequately allege “facts going to the basis for the issuer’s opinion . . . whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context.” \textit{Id.} at 194.

\textsuperscript{160} \textit{Id.} at 183.

\textsuperscript{161} This rationale thus abandons the due diligence defense standards of Section 11, thereby conflicting with the underpinning of this defense. A more consistent holding would have been that any such statement of belief or opinion must be made with a reasonable basis after conducting adequate due diligence with respect to such statement. Allowing corporate fiduciaries to engage in negligent (and even grossly negligent) expressions of optimism contained in Securities Act registration statements disserves the diligence functions underlying the registration process.

\textsuperscript{162} See \textit{STEINBERG}, supra note 56, at 183 (asserting that “it is not surprising that disclosure practices by publicly-held corporations are replete with statements of cherry belief and expressions of optimism [and that] all too frequently, these statements belic reality”).

\textsuperscript{163} See \textit{id.} at 181–85; see generally James D. Cox, “\textit{We’re Cool}” \textit{Statements After Omnicare}: \textit{Securities Fraud Suits for Failures to Comply with the Law}, 68 SMU L. REV. 715 (2013); Hilary A. Sale & Donald C. Langevoort, “\textit{We Believe}”: \textit{Omnicare}, \textit{Legal Risk Disclosure and Corporate Governance}, 66 DUKE L.J. 763 (2016).
2. Application of Fiduciary Standards under Exchange Act Section 10(b)

Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder by the SEC are the principal antifraud provisions of the federal securities laws. Undoubtedly, the thrust of the statute and rule is on adequate disclosure rather than substantive fairness. Nonetheless, fiduciary principles have been recognized by the Supreme Court in its construction of these provisions. For example, in its interpretation of insider trading liability under Section 10(b) and Rule 10b-5, the Court held that, absent the existence of a fiduciary duty or a relationship of trust and confidence, silence does not give rise to liability. That relationship, the Court opined, exists between corporate insiders, including officers and directors, and the shareholders of the subject corporation. As stated by the Court, "a relationship of trust and confidence [is present] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." By the fiduciary trading in her company's securities based on such confidential material information for her personal benefit, she breaches the duty owed to the subject corporation's shareholders.

---

164. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

165. See, e.g., Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739–49 (1975) (discussing the frequent invocation of these provisions by plaintiffs in federal securities litigation); BROMBERG ET AL., supra note 141, § 1:21.

166. See sources cited supra notes 136–38, 165.

167. See Chiarella v. United States, 445 U.S. 222, 227–35 (1980); id. at 228 (stating that the insider trading prohibition with respect to corporate fiduciaries is based on the recognition of "a relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation"); see also United States v. O'Hagan, 521 U.S. 642, 653–66 (1997) (premising § 10(b) insider trading liability under the misappropriation theory based on the trader's breach of fiduciary duty or duty of trust or confidence to the source of the material nonpublic information); Dirks v. SEC, 463 U.S. 646, 653–67 (1983) (holding that a tipper of material nonpublic information violates § 10(b) when she breaches her fiduciary duty or relationship of trust and confidence by tipping and that such breach is shown by proving that the tipper conveyed the information for personal gain or as a gift); see generally MARC I. STEINBERG & WILLIAM K.S. WANG, INSIDER TRADING (Oxford Univ. Press, 3d ed. 2010).

168. See Chiarella, 445 U.S. at 228; id. at 230 (stating that this duty arises "from a relationship of trust and confidence between parties to a transaction [and that] [a]pplication of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information"); see also sources cited supra note 167 (describing different insider trading decisions that consider different relationships between parties).

169. 445 U.S. at 228.

170. Id. at 226–30. By contrast, no breach of fiduciary duty must be shown in the tender offer situation. Rather, Rule 14c-3 extends the insider trading prohibition in connection with a tender offer transaction to all persons who become privy to material nonpublic information relating to a tender offer having reason to know that such information came, directly or indirectly, from an inside source. 17 C.F.R. § 240.14c-3. The consequence is that two different rationales of insider trading liability apply under federal law: in the tender offer setting, where liability exposure is expansive, and in all other situations, where liability exposure is far more confined. Such an approach is illogical and treats similarly situated persons in a disparate manner. See MARC I. STEINBERG, THE FEDERALIZATION OF CORPORATE GOVERNANCE 128 (Oxford Univ. Press 2018) (asserting that "[s]uch disparity in treatment without adequate justification cannot be reconciled with market integrity, investor protection, or fundamental principles of fair treatment among similarly-situated actors").

Another example of the presence of fiduciary duties under federal securities laws is the receipt of compensation by an investment adviser for its services. See Investment Company Act of 1940 § 36(b), 15 U.S.C. § 801-35(b). Rather than faithfully implementing this statute, an unduly lax standard is applied. Namely, to
Hence, although the federal securities laws (including Section 10(b)) are focused on disclosure, fiduciary duty-like principles arise in this setting. Indeed, as discussed above, the Supreme Court has expressly recognized, when construing the contours of Section 10(b) in the insider trading setting, that directors and officers have a relationship of trust and confidence with the shareholders of their corporations.\textsuperscript{171} With this principle established, it may be posited that when corporate officers and directors undertake their disclosure obligations under the federal securities laws, they must exercise due care and good faith. An insider’s failure to do so under this framework would subject them to liability exposure to the corporation’s shareholders who are injured by the alleged misconduct.\textsuperscript{172} This, however, is not the situation under Section 10(b) and Rule 10b-5. Rather, the Supreme Court and Congress have minimized the corporate insider-shareholder relationship with respect to the liability exposure of these fiduciaries.\textsuperscript{173}

For example, with respect to the mental culpability necessary to be proven under Section 10(b) and Rule 10b-5, the Supreme Court held nearly fifty years ago that intentional or knowing misconduct is required.\textsuperscript{174} Accordingly, under these provisions, corporate fiduciaries may engage in grossly negligent conduct yet avert liability.\textsuperscript{175} This

\textsuperscript{171} See discussion supra notes 164–70 and accompanying text.

\textsuperscript{172} By analogy, the duty of disclosure is recognized by the Delaware courts as coming within a director’s fiduciary duties of care and loyalty. See, e.g., Malone v. Brincat, 722 A.2d 5, 11 (Del. 1998) (“The duty of disclosure to observe proper disclosure requirements derives from the combination of the fiduciary duties of care, loyalty and good faith.”).

\textsuperscript{173} See infra notes 174–88 and accompanying text.

\textsuperscript{174} See Aaron v. S.E.C., 446 U.S. 680, 701 (1980) (requiring, \textit{inter alia}, scienter—knowing or intentional misconduct—to be proven by the SEC for violations of § 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976) (requiring scienter to be proven in private § 10(b) actions). Ordinarily, reckless misconduct is actionable under Section 10(b) and Rule 10b-5. See, e.g., \textit{In re Ikon Off. Sols., Inc. Sec. Litig.}, 277 F.3d 658, 667 (3d Cir. 2002) (defining reckless conduct as being conduct that is “highly unreasonable” and that is “an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it”).

\textsuperscript{175} There are certain provisions where negligence gives rise to private liability exposure. As discussed above, Section 11 provides a meaningful remedy for plaintiffs with respect to material disclosure deficiencies contained in a Securities Act registration statement. See \textit{supra} notes 142–57 and accompanying text. Another example is the proxy provisions, Section 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a), and Rule 14a-9 thereunder, 17 C.F.R. § 240.14a-9. When material misrepresentations and half-truths are contained in a proxy statement, a negligence level of culpability generally applies to assess the liability exposure of the subject company’s officers and directors. See, e.g., Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 777 (3d Cir. 1976) (“Since Section 11 of the Securities Act clearly establishes negligence as the test for determining liability, the parallel between the two sections would strongly support adoption of negligence as the standard under section 14(a).”); Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300 (2d Cir. 1975) (“[T]he common law itself finds negligence sufficient for tort liability where a person supplies false information to another with the intent to influence a transaction in which he has a pecuniary interest.”). \textit{But see} S.E.C. v. Das, 723 F.3d 923, 953 (8th Cir. 2013) (stating that while scienter must be shown under § 14(a) with respect to outside directors, a negligence-applicable standard is appropriate for corporate officers).
expansive insulation from liability is reinforced by several other lax standards. For instance, pursuant to the puffery doctrine, corporate fiduciaries may engage in nonactionable generalized expressions of optimism that are outright lies. These statements frequently focus on key aspects of the subject corporation’s business, such as its compliance with pertinent regulatory requirements, culture and reputation, clinical trial data, recent acquisitions, and implementation of scrupulous diligence practices. As courts have held, these generalized statements are neither material nor can they be justifiably relied upon by investors. Judicial invocation of the puffery doctrine in this fashion treats corporate fiduciaries as if they are “pre-owned” car salespersons.

Similarly, as discussed above, statements of belief or opinion made by corporate officers and directors are not actionable in private actions unless fraud is proven. Congress also has acted to confine fiduciary liability exposure in this area. Pursuant to the Private Securities Litigation Reform Act of 1995, Congress provided expansive protection for forward-looking statements made by an Exchange Act reporting company. Under this statute, forward-looking statements made by these companies are not actionable against their directors and officers in private litigation unless the plaintiff

176. See, e.g., Plumbers & Steamfitters Loc. 773 v. Danske Bank, 11 F.4th 90, 103–04 (2d Cir. 2021) (statements that bank conducts its business consistent with internationally recognized principles with respect to anti-corruption held puffery and thereby not actionable); Ind. Pub. Ret. Sys. v. SAIC, Inc., 818 F.3d 85, 97–98 (2d Cir. 2016) (laudatory statements regarding the company’s reputation and culture deemed puffery); Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1206–07 (9th Cir. 2016) (holding that the company touting its “strong credit culture and underwriting integrity” was mere puffery); Edinburgh Council v. Pfizer, Inc., 754 F.3d 159, 173 (3d Cir. 2014) (deeming puffery pharmaceutical company’s optimistic statements concerning clinical trial data); see also Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys., 141 S. Ct. 1951, 1958 (2021) (stating that “the generic nature of a misrepresentation often is important evidence of price impact that courts should consider at class certification”).

177. See, e.g., cases cited supra note 176.

178. See Raab v. Gen. Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993) (“‘Soft,’ ‘puffing’ statements . . . generally lack materiality . . .”); cases cited supra note 176. On the other hand, when the disclosures are viewed as sufficiently specific, many courts decline to apply the puffery doctrine. See, e.g., In re Level 3 Commc’ns Inc. Sec. Litig., 667 F.3d 1331, 1340–41 (10th Cir. 2012) (deeming actionable company’s statement that its integration was “85%, 90% done”); Gross v. GFI Grp., Inc., 162 F. Supp. 3d 263, 266–69 (S.D.N.Y. 2016) (statement by corporate executive that a potential acquisition candidate generated “a singular and unique opportunity to optimize value” held not puffery).


180. See discussion supra notes 158–63, 174 and accompanying text. In its enforcement actions, the SEC may be able to invoke Section 17(a)(2) and 17(a)(3) of the Securities Act, where liability may be predicated on negligence. See Aaron v. S.E.C., 446 U.S. 608, 695–700 (1980). Nonetheless, a showing of negligence may not be sufficient for the Commission to obtain injunctive relief. See Marc I. Steinberg, SEC and Other Permanent Injunctions— Standards for Their Imposition, Modification, and Dissolution, 66 CORNELL L. REV. 27 (1980).


182. Generally, an Exchange Act reporting company must file periodic reports (such as Forms 10-K, 10-Q, and 8-K) with the SEC and is subject to comprehensive disclosure and reporting obligations. See MARC I. STEINBERG, SECURITIES REGULATION 243–323 (8th ed. 2022). Generally, a forward-looking statement is future-oriented rather than based on historical information. Projections of future performance and asset appraisals are examples. See, e.g., Starkman v. Marathon Oil Co., 772 F.2d 231 (6th Cir. 1985).
proves that such fiduciaries had actual knowledge of the falsity.\textsuperscript{183} Going even further, the statute provides that if a forward-looking statement is accompanied by meaningful cautionary language that identifies significant factors that could cause actual results to materially differ from those projected, the forward-looking statement is not actionable as a matter of law in private litigation.\textsuperscript{184} Hence, upon company legal counsel artfully drafting the requisite cautionary statements,\textsuperscript{185} the company and its fiduciaries are immune from private liability—even if such insiders know that the projections being made are materially false.\textsuperscript{186}

Today, corporate officers and directors of national-stock-exchange-listed companies may cause their respective companies to deliberately engage in generalized false statements of optimism and knowingly make materially deceitful financial projections (that contain the requisite cautionary language) upon which investors justifiably rely without incurring private liability under the federal securities laws.\textsuperscript{187} For corporate directors and officers to engage in such conduct and not be held accountable to allegedly aggrieved shareholders is an affront to fiduciary duty principles. Hence, as with the situation in the corporate law context, directors and officers under the antifraud provisions of the federal securities law are fiduciaries largely in name only, lacking substantive application.\textsuperscript{188}

III. THE FIDUCIARY DUTY MISNOMER

Although corporate directors and officers are fiduciaries under applicable law, the


\textsuperscript{185. Of course, publicly-held corporations retain sophisticated in-house and outside attorneys that are experts in securities law disclosure practices and draftsmanship to undertake this function. See generally MARC I. STEINBERG, LAWYERING AND ETHICS FOR THE BUSINESS ATTORNEY (5th ed. 2020).}

\textsuperscript{186. See, e.g., Asher v. Baxter Int’l, Inc., 377 F.3d 727, 730–34 (7th Cir. 2004) (acknowledging that, irrespective of the actor’s state of mind, if the forward-looking statement is accompanied by the requisite cautionary language, the “statutory safe harbor forecloses liability”).}

\textsuperscript{187. See discussion supra notes 181–86 and accompanying text.}

\textsuperscript{188. In my recent Oxford University Press book, this point was made. See STEINBERG, supra note 56, at 183 (“For corporate officers and directors to act in this manner and not be held accountable to shareholders makes a mockery of fiduciary duty principles.”).}
legal standards applied to determine their liability exposure frequently do not implicate duties of utmost trust and confidence. Rather, permissive standards often prevail that enable these fiduciaries to avoid liability unless they act with gross negligence or greater culpability.\textsuperscript{189} Indeed, in many situations, reckless or intentional misconduct must be proven for liability to be imposed.\textsuperscript{190} And, on occasion, private liability is not incurred even when corporate insiders act with deliberate misconduct.\textsuperscript{191}

Sound policy justifications may be provided to support several of these provisions. For example, the business judgment rule incentivizes boards of directors to undertake challenging entrepreneurial or managerial tasks without incurring an undue risk of being sued based on alleged misconduct by hindsight.\textsuperscript{192} The deployment of the special litigation committee, comprised of independent and disinterested directors authorized to seek the dismissal of shareholder derivative suits, enables corporations and their fiduciaries to rid themselves of lawsuits that are not in the subject company’s best interests.\textsuperscript{193} In this respect, the use of independent directors in a myriad of settings to perform their committee and oversight tasks in hopefully an objective and competent manner without incurring undue risk of personal liability enhances sound corporate governance practices.\textsuperscript{194} And, in

\begin{enumerate}
\item[189.] For example, the application of the business judgment rule insulates directors from liability unless they act with gross negligence. The director exculpation charter provisions provide an additional layer of protection from monetary liability. See discussion supra notes 40, 59 and accompanying text.
\item[190.] For example, private liability may be imposed in Section 10(b) private damages actions only if intentional or reckless misconduct is proven. See discussion supra notes 43–60 and accompanying text. The standard under Delaware law for showing a lack of good faith by directors with respect to the efficacy of their company’s information and reporting system requires that such directors utterly or consciously fail to adhere to their responsibilities, amounting to conduct that is at least reckless. See discussion supra notes 61–72 and accompanying text.
\item[191.] This situation occurs, for example, with respect to the disclosure by a publicly-held corporation of materially false forward-looking statements accompanied by the requisite cautionary language. In such circumstances, even when directors and officers have actual knowledge that the statements are fraudulent, they cannot be held liable in private actions under the PSLRA’s safe harbor. See discussion supra notes 182–86 and accompanying text.
\item[192.] Hence, the business judgment rule is one of judicial non-review of board of director decisions that come within the rule’s parameters. The rationale underlying the rule is the principle that courts should not interfere with business decisions made in good faith by an impartial board of directors. See Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (“The rule operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation . . . [and] posits a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be attributed to any rational business purpose.”); discussion supra notes 43–60 and accompanying text.
\item[193.] See Zapata, 430 A.2d at 785 (stating that “[e]ven when demand is excusable, circumstances may arise when continuation of the litigation would not be in the corporation’s best interests” and, in such instances, the corporation should be able to “rid itself of detrimental litigation”); discussion supra notes 81–88 and accompanying text.
\item[194.] The proper role and conduct of independent directors are fundamental corporate governance issues that arise with regularity. Today, for example, as a condition of national stock exchange listing, with specified exceptions, a subject company must have a majority of independent directors on its board of directors. See In re New York Stock Exchange, Inc.; Securities Exchange Act Release No. 34–47672 (Apr. 11, 2003); Securities Exchange Act Release No. 34–48745 (Nov. 4, 2003). Pursuant to the Sarbanes-Oxley Act (SOX), a publicly-held company’s audit committee must consist solely of independent directors. See SOX § 301; Rule 10A–3, 17 C.F.R. § 240.10A–3. And, under the Dodd-Frank Act, all members of a publicly-held company’s compensation committee must consist of independent directors. See Exchange Act § 10C, 15 U.S.C. § 78j–3; Rule 10C–1, 17 C.F.R. § 240.10C–1. These developments are addressed in STEINBERG, supra note 10, at 191–262.
\end{enumerate}
the securities law setting, the application of a scienter culpability standard and onerous pleading requirements in Section 10(b) litigation deters the initiation of vexatious litigation brought for inducing corporate defendants to settle lawsuits rather than being saddled with onerous discovery burdens.\footnote{195}

An overriding yet not frequently stated objective of these lax liability standards is the presence of independent directors on corporate boards. As a condition of having its stock listed on a national securities exchange, a company must have a majority of independent directors as members of its board of directors.\footnote{196} In addition, under the Sarbanes-Oxley Act\footnote{197} and the Dodd-Frank Act,\footnote{198} a subject corporation’s audit and compensation committees must be comprised solely of independent directors.\footnote{199} Indeed, many New York Stock Exchange companies have an overwhelming majority of independent directors on their corporate boards, with three or fewer inside directors.\footnote{200}

Applying relatively strict liability standards would dissuade outside directors from serving on corporate boards. Generally, outside directors of companies listed on a national securities exchange are individuals with solid personal reputations and financial means.\footnote{201}

\footnote{195. The Supreme Court has forcefully made this point in a number of its decisions. See, e.g., Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc., 552 U.S. 148, 163 (2008) (asserting that § 10(b) actions give rise to “extensive discovery and the potential for uncertainty and disruption [that] allow plaintiffs with weak claims to extort settlements from innocent companies”); Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 189 (1994) (pointing to the danger of § 10(b) actions being “vexatious”); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975) (asserting that “litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general”).

With respect to pleading standards, additional burdens are placed on plaintiffs. See Securities Act § 27(c); Exchange Act § 21D(c); Tellabs, Inc. v. Makor Issues & Rs., Ltd., 551 U.S. 308, 324 (2007) (requiring that a complaint must plead facts constituting a “strong inference” of scienter and such complaint will survive a motion to dismiss “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged”).

\footnote{196. See sources cited supra note 194.}


\footnote{199. See sources cited supra note 194.

\footnote{200. Indeed, it is not unusual for the chief executive officer of a New York Stock Exchange listed company to be the only inside director on the company’s board of directors. See, e.g., AT&T Inc., Proxy Statement (Form 14A) (Mar. 11, 2021); Apple Inc., Proxy Statement (Form 14A) (Jan. 5, 2021); Campbell Soup Co., Proxy Statement (Form 14A) (Oct. 2, 2020); Exxon Mobil Corp., Proxy Statement (Form 14A) (Mar. 16, 2021); Johnson & Johnson, Proxy Statement (Form 14A) (Mar. 10, 2021).

\footnote{201. Outside directors often are current or retired executives of other publicly-held companies, current or retired partners of financial firms, retired partners of accounting firms, “professional” directors, former politicians, and academicians, particularly university presidents. See, e.g., Apple Inc., Proxy Statement (Form 14A) (Jan. 5, 2021) (outside directors’ occupations include, among others: Retired Global CEO, PricewaterhouseCoopers International Limited; Former President and CEO, Federal Reserve Bank of Dallas; Member and CEO, Westrock Group, L.L.C.; Retired Chairman of the Board and CEO, Humana Inc.); Exxon Mobil Corp., Proxy Statement (Form 14A) (Mar. 16, 2021) (outside directors’ occupations include, among others: Chairman of the Board & CEO, Merck & Co.; Former Chairman of the Board, President & CEO, MetLife; Former Chairman of the Board, President & CEO, Caterpillar; Former Chairman of the Board, President & CEO, IBM).
While serving on a corporate board that has attractive financial benefits may be a worthwhile professional endeavor for directors, the presence of litigation attacking their integrity and competence with adverse financial consequences is not to their liking. Even if adequate insurance and indemnification are available, the specter of contentious litigation impugning one's reputation is not an acceptable accommodation. The onslaught of private litigation with investor-friendly remedial provisions would create the distinct risk that many independent directors would decline to serve on corporate boards. The materialization of this concern would significantly impair sound corporate governance practices and pose a cognizable threat to the integrity of disclosure and internal control processes.

Although the above concerns are meritorious, there are countervailing considerations that should be accorded prominence. The implementation of sound corporate governance and disclosure practices are more likely to come to fruition with meaningful, yet not excessive, consequences for noncompliance. Exhortation for corporations and their

---

202. The fallout from the Delaware Supreme Court's decision in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), provides such an example. There, the Delaware Supreme Court held that the defendant directors breached their duty of care, facing the prospect of over $133 million in monetary damages ($65 per share less $55, the price shareholders received, multiplied by the number of shares outstanding). The case settled for $23.5 million, which exceeded the amount insured. Bill Barnhart, *Trans Union Suit to Cost $23 Million*, Chi. Trib. (Aug. 3, 1985), https://www.chicagotribune.com/news/ct-xpm-1985-08-03-8502200808-story.html [https://perma.cc/7MJC-AHKB]. The decision's perceived impact resulted in qualified individuals being reluctant to serve on corporate boards as outside directors (due in part to the increased costs and more limited coverage of director and officer liability insurance). See 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, 455–56 (2002); Velasco, supra note 86, at 831. State legislatures responded by enacting director exculpation statutes that (provided a charter provision is included in the subject company's articles of incorporation) eliminate monetary liability for breach of the duty of care. See, e.g., Del. Gen. Corp. L. § 102(b)(7); discussion supra notes 40–60 and accompanying text.

203. The availability and scope of insurance coverage after the Delaware Supreme Court's decision in *Trans Union* reportedly was troubling. See Dennis R. Honabach, Smith v. Van Gorkom: *Managerial Liability and Exculpatory Clauses — A Proposal to Fill the Gap of the Missing Officer Protection*, 45 WASHBURN L.J. 307, 311–12 (2006); James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988). Insofar as indemnification is concerned, the subject company, of course, must have sufficient assets to provide this protection to deserving corporate fiduciaries. Nonetheless, critics assert that current flexible indemnification statutes, permissive corporate indemnification provisions, and the cultural bias of nondefendant directors, in effect, result in the corporation and its shareholders incurring the costs of these settlement payments. See *Steinberg*, supra note 56, at 206–08 (proposing that, in order for indemnification to be provided to inside directors and executive officers for amounts paid in settlement, disinterested shareholder approval should be required); Susan Beck, *Summary Judgment: Until Directors and Officers Start Paying Some of Their Legal Fees, Corporate Accountability Is a Myth*, AM. LAW., Feb. 3, 2010 (asserting that "there's a moral hazard in corporate boardrooms and executive suits, [namely,] . . . ridiculously cushy indemnification contracts that insulate directors and officers from responsibility for their own actions.")

204. Hence, while it is vital that vibrant corporate governance and disclosure mandates apply to maintain transparency and the integrity of internal controls, undue monetary liability levied upon outside directors would substantially impair this objective. Qualified outside directors understandably would be deterred from serving on corporate boards if the litigation risks and indemnification policies were unduly disadvantageous. Current indemnification procedures thus should remain intact for outside directors. Moreover, unless a corporate fiduciary engages in grossly negligent or more culpable misconduct, a cap on damages should be enacted that limits monetary liability to the greater of such individual's: "(1) total annual compensation (including equity compensation benefits), (2) fees and other revenues derived from the engagement, or (3) $100,000." *Steinberg*, supra note 56, at 205.
insiders to undertake so-called best practices frequently is an empty gesture unless adversity flows from conduct that is incompatible with sound corporate governance customary conduct. Accordingly, the recommended approach is to establish meaningful standards of director and officer conduct that have liability consequences within the contours of a sensible remedial framework.

To provide a more even-handed investor framework, while not imposing undue liability exposure upon corporate fiduciaries, a nearly uniform negligence standard should apply with a concomitant cap of damages. When the challenged conduct involves decisions or disclosures based on information that can be factually verified to a reasonable degree, the appropriate standard to hold corporate fiduciaries primarily liable is negligence. Although this proposal may appear expansive, its impact is moderated by the fact that the negligence standard has been applied for decades under specified remedial provisions of the federal and state securities acts. A more lenient standard should apply to conduct involving decisions or disclosures based on future-oriented information that cannot be factually verified at that time. For example, a subject company’s projections of future financial performance fall into this category. This standard, however, should not be as permissive as current law provides. Rather, this conduct should be insulated from liability provided that the fiduciary acts in good faith and without gross negligence. No meritorious public policy rationale exists for giving a free pass for corporate fiduciaries to act as miscreants. A fiduciary’s egregiously careless or bad faith conduct should not be

205. The gap between “best practices” and liability standards is wide. See, e.g., MBCA § 8.30 and Official Comment (In setting forth standards of conduct for directors, the Official Comment states: Although “address[ing] standards of conduct—the level of performance expected of directors undertaking the role and responsibilities of the office of director” —“[t]he section does not address the liability of a director.”).


207. Under the current federal securities law liability framework, different liability consequences can ensue from identical conduct. For example, a proxy statement used to solicit shareholders in connection with a merger transaction can give rise to monetary liability under Section 14(a) and Rule 14a-9 if corporate fiduciaries were negligent but does not result in Section 10(b) liability which requires scienter. See sources cited supra notes 174–75. The same inconsistent result follows with respect to a Securities Act registration statement. While rigorous liability standards apply under Section 11 (and, indeed, the issuer has no due diligence defense), scienter must be proven under Section 10(b). See sources cited supra notes 142–63, 174–75.

208. Under the federal securities laws, Sections 11 and 12(a) of the Securities Act and Section 14(a) of the Exchange Act are examples. Indeed, with respect to material misstatements contained in a registration statement, the corporation issuing its securities has no due diligence defense. See supra notes 142–63 and accompanying text. Moreover, with respect to Securities Act registration violations, Section 12(a)(1) imposes strict liability upon the seller of the subject securities in an action brought by its purchaser. 15 U.S.C. § 77l(a)(1). With respect to the state securities laws, Section 410 of the Uniform Securities Act contains a negligence standard, requiring the subject defendant to establish that it exercised reasonable care as an affirmative defense. See generally JOSEPH LONG, MICHAEL KAUFMAN & JOHN WUNDERLICH, BLUE SKY LAW (2021).

209. As discussed above, current law for eligible Exchange Act reporting companies provides a safe harbor precluding private liability if the forward-looking statement is accompanied by the requisite cautionary disclosures. If not, then private liability may ensue only if actual knowledge is proven by the plaintiff. See supra notes 181–86 and accompanying text.

210. This standard should provide sufficient incentive for fiduciaries to disclose forward-looking statements without insulating egregiously careless, forward-looking statements from successful challenges in meritorious cases. After all, by analogy, this standard applies the broad umbrella of concepts underlying the business judgment rule to protect fiduciaries who act without gross negligence. See discussion supra notes 43–60 and accompanying text.
countenanced.\textsuperscript{211} Unless a plaintiff establishes that a defendant fiduciary acted with palpable misconduct, a cap on damages should be implemented. Palpable misconduct may be proven by establishing that the subject director or officer engaged in grossly negligent, reckless, or intentional misconduct.\textsuperscript{212} Where such misconduct is not shown, a defendant fiduciary’s monetary liability would be capped at the greater of such person’s total annual remuneration (inclusive of equity compensation benefits as well as director, consulting, and other professional fees) or $100,000.\textsuperscript{213} Although this proposal does not negate in its entirety the prospect of private litigation being instituted without a reasonable basis against corporate fiduciaries in an effort to circumvent the damages cap,\textsuperscript{214} its strength is the disciplined application of meaningful norms of insider conduct with judicial scrutiny to ensure that officers and directors are not subject to undue liability exposure.\textsuperscript{215} Rigorous judicial assessment of sanctions against plaintiffs and their legal counsel who bring frivolous or other meritless claims would constitute a strong deterrent from instituting such claims.\textsuperscript{216}

Absent the occurrence of major financial scandals or other catastrophic events, the

\textsuperscript{211} In this regard, aiding and abetting liability should be restored under the federal securities laws. Prior to the Supreme Court’s decision in \textit{Central Bank v. First Interstate Bank of Denver}, 511 U.S. 164 (1994), lower courts had consistently and uniformly recognized this right of action against secondary actors. See id. at 192 (Stevens, J., dissenting) (emphasis in original) (“In hundreds of judicial and administrative proceedings in every circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.”). As the law currently stands, such miscreant collateral actors avoid liability in private actions under federal securities laws. See, e.g., Pac. Inv. Mgmt. Co. L.L.C. v. Mayer Brown L.L.P., 603 F.3d 144 (2d Cir. 2010) (holding misconduct involved did not give rise to primary liability under § 10(b), hence no liability even though law firm partner went to prison for his transgressions).

\textsuperscript{212} Under current law, negligence is actionable with no cap on damages under certain provisions of the federal securities laws. See supra note 208 and accompanying text. Nonetheless, corporate fiduciaries are generally subject to proportionate liability unless they act with intentional misconduct, subject to certain exceptions (such as under § 11 of the Securities Act, where corporate officers and inside directors are subject to joint and several liability—with a right to seek contribution under specified circumstances). See Securities Exchange Act § 21D(f). Moreover, forward-looking statements are insulated from liability in private actions if accompanied by the requisite cautionary disclosure. If not, then the plaintiff must prove the defendant’s actual knowledge. See supra notes 181–86 and accompanying text.

\textsuperscript{213} If the outside director renders consulting or professional services to the subject company, then the amount in fees and other revenues derived from the engagement would be included in the calculation of the damages cap. The damages cap would not apply if the director engaged in grossly negligent or more culpable misconduct. See STEINBERG, \textit{supra} note 56, at 205.

\textsuperscript{214} In situations where plaintiffs’ counsel institutes frivolous or other meritless litigation, the award of attorneys’ fees and the levy of sanctions would be appropriate. Section 27(c) of the Securities Act, Section 21D(c) of the Exchange Act, and Rule 11 of the Federal Rules of Civil Procedure grant the district court authority to order sanctions where warranted. In addition, pursuant to the Private Securities Litigation Reform Act, the plaintiffs cannot obtain discovery until a motion to dismiss (if filed) is fended off. See Securities Act § 27(b); Exchange Act § 21D(b)(3). If faithfully administered, these measures strongly deter the initiation of frivolous or meritless federal securities litigation.

\textsuperscript{215} The presence of a meaningful cap on damages, a near-uniform culpability level, the flexible availability of indemnification for outside directors, and the levy of sanctions for the bringing of frivolous actions should enhance corporate governance processes, not saddle corporate fiduciaries with unduly harsh private liability exposure and provide investors with meaningful redress. With respect to a cap on damages, other countries have successfully instituted this measure. See, e.g., Ontario (Canada) Province of Ontario Securities Act, R.S.O. 1990, c.S.5, §§ 138.1, 138.7.

\textsuperscript{216} See sources cited \textit{supra} note 214.
implementation of a sounder remedial framework having as a key component a balanced cap on damages is remote.\textsuperscript{217} From all indications, the current liability schemes under federal and state law are ensconced and unlikely to undergo substantial modification. A consequence is the continued illusory portrayal of corporate insiders being obligated to adhere to meaningful fiduciary standards. As this Article has demonstrated, this portrayal is one of fiction. While the rhetoric remains loud, the substance underlying the rhetoric is barely audible.

IV. CONCLUSION

Assuming that the rules of the Kentucky Derby permitted, to enter a donkey in this prestigious race as Secretariat\textsuperscript{218} would engender incredulity among the populace. Yet, by analogy, this practice has been accepted for many decades under state corporate and federal securities law. The time is past due to terminate this illusion. Although called fiduciaries, standards applied to officer and director conduct are frequently devoid of due care and utmost loyalty. The myth of insider fiduciary standards departs from fact. Therefore, the label of fiduciary should be deleted from officer, director, and controlling shareholder status. In its stead, the standards required of these persons should be categorized as \textit{sui generis}. In this fashion, the current framework for insider conduct would reflect reality. No longer in the sphere of director and officer conduct would a donkey be called a racehorse.

\textsuperscript{217} In the aftermath of massive multi-billion-dollar frauds perpetrated upon public investors, the enactment of the Sarbanes-Oxley Act of 2002 federalized corporate governance to an extent previously thought unattainable. Federal law mandating the composition and functions of the audit committee, implementation of codes of conduct, and outright prohibition of specified fiduciary conduct previously relegated solely to state law (e.g., a bar with respect to loans extended to corporate officers and directors) evidences that on occasion the unexpected can happen. The occurrence of major financial scandals in the future, which inflict substantial damage to the financial markets and investors, may spur Congress to take further measures to federalize corporate governance and enact a balanced private liability framework.

\textsuperscript{218} "Secretariat [winner of the Triple Crown] was a legendary thoroughbred racehorse whose name reigns supreme in the history of racing." \textit{Secretariat}, HISTORY.COM (Apr. 30, 2018), https://www.history.com/topics/sports/secretariat [https://pcrma.cc/W3FE-HUR6]. His performance at the Belmont Stakes, the third leg of the Triple Crown, "where he bested his closest competitor by a mind-blowing 31 lengths, is widely considered one of the most stunning horse races of all time." \textit{Id.}