Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Disclosure

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TRANSPARENCY AND ACCOUNTABILITY: 
RETHINKING CORPORATE FIDUCIARY LAW'S RELEVANCE TO CORPORATE DISCLOSURE

Faith Stevelman Kahn

The claim of this Essay is twofold: first, that corporate fiduciary law has an important contribution to make to the regulation of corporate managers' participation in corporate reporting and disclosure, and, second, that the fundamental principles of corporate fiduciary law are brought into focus when the problem of managerial misrepresentation to shareholders is examined from this perspective. This reconsideration of the connection between corporate fiduciary law and corporate disclosure to shareholders has significant implications for the teaching of the basic Corporations course, and most particularly its discussion of corporate fiduciary law's protection of shareholders' interests. In relation to the latter, the Essay contends that courts will not be able to take a laissez faire or highly formalistic approach to adjudicating shareholder claims of managerial mendacity without impairing the conceptual coherence and moral, aspirational force of corporate fiduciary law. The comments herein address the informational needs and rights of shareholders in publicly held corporations—the focus on governance.

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1 My understanding is that corporate disclosure to shareholders is addressed within the introductory Corporations or Business Associations course principally and frequently exclusively in relation to proxy voting in public corporations, as regulated by federal law. Securities Exchange Act of 1934, ch. 14, 48 Stat. 88 (codified as amended at 15 U.S.C. § 78n (1994)); SEC Rule 14a-3. Shareholders' need for accurate corporate disclosure as the basis for exercising their other crucial governance right—their right to make informed choices vis-à-vis holding or selling their shares—has received comparatively little attention within the basic course and the literature on corporate governance.

2 This Essay is part of a broader inquiry I have undertaken regarding the relationship between corporate misrepresentation, corporate fiduciary law, and the rights of holders of corporate equity.
issues in publicly held firms being consistent with many but certainly not all of the introductory business law courses.\(^3\)

Historically, there has been substantial consensus surrounding the importance of fiduciary law within the basic Corporations course.\(^4\) In scrutinizing the concept of fiduciary care, the standard curriculum has employed the case of *Smith v. Van Gorkom*,\(^5\) for example, as a vehicle for discussing directors' obligations to become properly informed about corporate affairs prior to making a decision for the firm.\(^6\) By reading cases like *Globe Woolen Co. v. Utica Gas & Electric Co.*,\(^7\) and corporate opportunity cases like *Thorpe v. Cerbo*,\(^8\) students have analyzed directors' and officers' fiduciary duty of loyalty in relation to the problem of managerial self-dealing in corporate property.\(^9\) And in the takeover cases, students have have

\(^3\) See Robert B. Thompson, *The Basic Business Associations Course: An Empirical Study of Methods and Content*, 48 J. LEGAL EDUC. 438 (1998) (giving survey results from professors who teach basic Corporations or Business Associations course). In regard to private firms, the inapplicability of the securities laws' affirmative disclosure mandate on the one hand, and the absence of an established trading market into which shareholders could readily sell their shares, on the other, means that the informational rights and interests of shareholders therein demand separate consideration.


\(^5\) 488 A.2d 858 (Del. 1985). The case is featured in most of the major casebooks. Nevertheless, consistent with the dynamic, evolutionary nature of fiduciary law, one scholar has taken the iconoclastic position that the case is an "outlier" better omitted from the basic course. Lawrence A. Hamermesh, *Why I Do Not Teach Van Gorkom*, 34 GA. L. REV. 477 (2000).

\(^6\) Van Gorkom, 488 A.2d at 872.

\(^7\) 121 N.E. 378 (N.Y. 1918).

\(^8\) No. 11,713, 1995 WL 478954 (Del. Ch. Aug. 9, 1995).

\(^9\) This focus on managerial self-dealing in corporate property is consistent with both the case law and mainstream corporate legal scholarship on corporate fiduciary loyalty. See, e.g., David Morris Phillips, *Managerial Misuse of Property: The Synthesizing Thread in Corporate Doctrine*, 32 RUTGERS L. REV. 184, 184-85 (1979) (suggesting that corporate law doctrine prohibits wrongful use of corporate property by those controlling it). Former Chancellor
analyzed managers' duties of loyalty to shareholders in relation to such managers' efforts to retain corporate control, and thus their power and compensation, against the wishes, and potentially best interests, of the shareholders.\(^{10}\)

At a deeper, more conceptual level, however, it becomes evident that the doctrines of fiduciary care and loyalty are both concerned fundamentally with directors' and officers' stewardship over their firms' information. These doctrines obligate managers to oversee the gathering, internal and public reporting and the "deployment" of corporate information consistent with their firms' and their shareholders' best interests. Notwithstanding the aforesaid, the conventional focus within the duty of loyalty on "secret profit-taking" has privileged the concern for the material effects of managers' rent seeking, whereas the problematic effects of the secrecy or lack of transparency in such managerial conduct has, in itself, received less


\(^{10}\) See, e.g., Quickturn Design Sys., Inc. v. Mentor Graphics Corp., 721 A.2d 1281, 1283 (Del. 1998) (finding redemption provision in shareholder rights plan invalid); Williams v. Geier, 671 A.2d 1368, 1379 (Del. 1996) (holding that when stockholders are given all necessary information relevant to defensive recapitalization plan their vote is dispositive); Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1373 (Del. 1995) (holding that when board's defensive action is within range of reasonableness, action will be evaluated under traditional business judgment rule); Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994) (finding Revlon duties apply to transactions involving sales of control); Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) (discussing circumstances under which business judgment rule applies to corporate takeover decisionmaking); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1985) (stating that duty of directors when company is being sold is to maximize company's value for stockholders); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (holding that board will enjoy protection of business judgment rule, in suits challenging propriety of its takeover defenses, where directors demonstrate their good faith, reasonable investigation and proportionality of defenses).
consideration. Yet the latter concern is more fundamental than the former, of course, since without transparency there cannot be any meaningful accountability in management's conduct.

Courts' and commentators' difficulty in articulating the compelling, foundational principles of corporate fiduciary law—such as the norm of honesty in management's communications to shareholders as it affects shareholders' exercise of their corporate governance rights, as discussed herein—has left corporate fiduciary law vulnerable to criticism, erosion and, eventually, displacement. Indeed, even a superficial glance at the academic literature reveals that corporate legal scholars hold starkly divergent views about the significance of corporate fiduciary law,¹¹ about the appropriateness of the relatively laissez-faire way that it has been applied by the state courts,¹² and the zealous manner in which it has been employed by shareholder litigants¹³ (and, more problematically, their lawyers).¹⁴ Corporate legal scholars' sustained approba-


¹² Compare, e.g., Brudney, supra note 4, at 615 ("Possibly the dilution of fiduciary loyalty strictures in the context of corporate management responds to perceptions of lesser need (because of the restraining influence of market pressures and reputational concerns) and of larger net costs of over-prohibiting than in the cases of agency and trusts or partnership. But the perceptions of lesser need or greater cost are hard to justify." (citations omitted)) with Frank H. Easterbrook & Daniel R. Fischel, Contract and Fiduciary Duty, 36 J. L. & ECON. 425 (1993) (illustrating similarities between doctrine of fiduciary duty and contract law doctrine).


tion of the operation of the capital markets and even the threat of corporate takeover as the principal mechanisms promoting managerial discipline \(^{15}\) has put pressure on corporate fiduciary law—and those who teach it—to justify the costs involved in its enforcement \(^{16}\) and, thus, its continued centrality within discussions of corporate governance, including those taking place in the classroom.

Nevertheless, although certain influential academic commentators have weighed in in favor of limiting the compass of corporate fiduciary law, and thus, presumably its significance within the Corporations curriculum, economic and technological changes described under the rubric of the "Information Age" are pushing in favor of fiduciary law's doctrinal expansion.\(^{17}\) Such developments are likely to accelerate the evolution of standards of fiduciary care, loyalty, and good faith \(^{18}\) as these standards are applied to managers'

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15 See Jeffrey N. Gordon, 'Just Say Never?' Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett, 19 CARDOZO L. REV. 511, 515 n.13 (1997) ("[I]t is myopic to focus on the costs and benefits of particular hostile takeovers, even in the aggregate. The most important impact is systematic, the way that a credible threat of a hostile takeover leads management to focus on capital market signals, which in turn leads firms to be highly adaptable to competitive market changes. Because there are no complete substitutes for hostile takeovers, shutting down that threat will also have systematic effects.").

16 See supra note 14.

17 These developments are likely to effect a steady, incremental elevation in what is expected of directors in terms of implementing information-gathering and reporting systems that are consistent with prevailing industry norms. In addition, advances in information technology are likely to affect the corporate opportunity doctrine (an aspect of fiduciary loyalty), as they raise problems regarding the ownership of information.

18 Because managers' obligations to oversee and participate in internal and external reporting do not fit neatly into the standard analytic constructs of fiduciary "due care" or "loyalty," directors' "good faith" obligation appears to be expanding, or at least assuming a heightened presence within the judicial discourse, in response to this analytic challenge. See, e.g., Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) ("The issue in this case is not whether Mercury's directors breached their duty of disclosure. It is whether they breached their more general fiduciary duty of loyalty and good faith by knowingly disseminating to the stockholders false information about the financial condition of the company."); In re Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996) ("[I]n my opinion, only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."). My own view is that it is analytically superior for courts and commentators to affirm that a norm of honesty applies to directors' public communications (as well as their dealings in corporate and shareholder property) as a matter of fiduciary loyalty doctrine, instead of searching for firm conceptual
oversight of the production, refinement, and presentation of data material to the firm. The production of high quality data and the ability to organize and present such data accurately and coherently to the relevant corporate decisionmakers is essential to promoting optimal decisionmaking and, thus, value creation in the firm’s and its shareholders’ best interests. As advances in information technology both fuel and are fueled by increased globalization of trade and the capital markets, and as these developments in turn expose firms to heightened competition, corporate directors and officers will be called upon to oversee and employ increasingly sophisticated, comprehensive and accurate “information technology” systems capable of organizing and presenting the appropriate, ground in the notoriously murky world of “good faith.” For discussion of the good faith standard and the definitional problems attendant thereto, see Claire Moore Dickerson, Cycles and Pendulums: Good Faith, Norms and the Commons, 54 WASH. & LEE L. REV. 399 (1997); Melvin A. Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 FORDHAM L. REV. 437 (1993). See also In re RJR Nabisco Shareholders Litig. [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194 at 91,711 (Del. Ch. Jan. 31, 1989) (discussing application of good faith in context of tender offer).

19 In his opinion in Caremark, William Allen connected this directorial responsibility to oversee the production of information to the board’s statutory monitoring responsibilities. Caremark Int’l, 698 A.2d at 970 ("Secondly, I note the elementary fact that relevant and timely information is an essential predicate for satisfaction of the board's supervisory and monitoring role under Section 141 of the Delaware General Corporation Law.").

20 An obvious example would be the potential combination of Great Britain’s Vodafone Airtouch, PLC (currently the world’s biggest mobile phone company) with Germany’s Mannesmann AG, a telecommunications and engineering company that currently represents that country’s largest mobile phone company. If the proposed stock-swap succeeds, the combined company would have stakes or control in twenty-five countries, including the largest cellular phone markets in the United States. The proposed combination had been opposed by Mannesmann’s chairman, most of its 130,000 employees, and German labor leaders and politicians, including German Chancellor Gerhard Schroeder. The explosion of “E-commerce” is also a relevant example.

21 For an appropriately rich and modern view of the scope of corporate governance, and the financial forces influencing its evolution, see Jeffrey N. Gordon, The Shaping Force of Corporate Law in the New Economic Order, 31 U. RICH. L. REV. 1473 (1997). To the extent that better governance contemplates professional corporate managers who are able to gather and decipher the appropriate capital market signals, the transition away from conventional stock exchanges to electronic ones may present interesting new challenges and opportunities. See, e.g., Greg Ip & Randall Smith, Tense Exchange: Big Board’s Members Face Off on the Issue of Automated Trading, WALL ST. J., Nov. 15, 1999, at A1 (discussing chasm between brokerage firms and the New York Stock Exchange regarding automated trading).

22 This trend is evident in the increasing prominence of the “Chief Information Officer” (or other person with such responsibility) within the ranks of senior executive officers.
accurate information to the relevant corporate decisionmakers.\textsuperscript{23} Because, in addition to the board and the senior executive officers, shareholders must also be considered an important class of corporate decisionmakers,\textsuperscript{24} the corporate business affairs that managers will be responsible for monitoring will increasingly be regarded as encompassing its public disclosures to shareholders.\textsuperscript{25}

In fact, corporate directors and senior executive officers have already inherited increased responsibility, as a matter of fiduciary care, for ensuring that appropriate systems of information-gathering and (internal and public) reporting operate within their firms. William Allen's now famous dicta in \textit{In re Caremark International, Inc. Derivative Litigation} indicates that managers will be looked to, as a matter of fiduciary care, to administer appropriate, efficacious systems of internal information-gathering and reporting.\textsuperscript{26} In addition, Allen's acknowledgment in \textit{Caremark} of directors' responsibilities for overseeing \textit{internal} information-gathering and reporting systems has established a doctrinal and conceptual foundation, albeit retrospectively, for the Delaware Supreme Court's recognition of directors' obligations to monitor the integrity of their firms' \textit{public disclosures} in the interest of shareholders, as was first articulated in the court's 1985 \textit{Van Gorkom} decision.\textsuperscript{27}

\textsuperscript{23} This concern is reflected in the increased emphasis within the corporate governance literature on the proper composition and functioning of audit committees of the board of directors. \textit{E.g.}, Blue Ribbon Commission Report on Improving the Effectiveness of Corporate Audit Committees (1999) (on file with author).

\textsuperscript{24} This assertion is consistent with this Essay's argument that "actively staying put" (in addition to voting and selling) is a shareholder decision that substantially affects not only the individual shareholders in question but also the status of the firm.

\textsuperscript{25} The expanded judicial recognition of shareholders' informational dependence on corporate press releases and disclosures made public through SEC filings (such as forms 10-Q, 10-K, and 8-K), in addition to proxy disclosures and management's tender-offer-related disclosures on Schedule 14D-9, is reflected in microcosm in the transition from the chancery court's to the Delaware Supreme Court's decision in \textit{Malone v. Brincat}, C.A. No. 15510 (Del. Ch. Oct. 30, 1997), \textit{aff'd in part, rev'd in part}, \textit{722 A.2d 5} (Del. 1998). The Delaware Supreme Court wisely rejected the idea that a request for a shareholder action on the part of the board should be dispositive of whether the communication implicates shareholders' corporate governance rights, and thus directors' fiduciary duties to shareholders. \textit{Malone v. Brincat}, \textit{722 A.2d 5}, 12 (Del. 1998).

\textsuperscript{26} \textit{In re Caremark Int'l, Inc. Derivative Litig.}, 698 A.2d 959, 970 (Del. Ch. 1996).

\textsuperscript{27} \textit{Smith v. Van Gorkom}, 488 A.2d 858, 889-893 (Del. 1985) (concluding directors breached fiduciary duty of candor by their failure to make true and correct disclosures of all information material to shareholders' vote on proposed merger).
There is indeed a seamlessness between directors' fiduciary care responsibility to oversee internal information-gathering and reporting systems, which provide information essential to the directors' monitoring of corporate business affairs, and their fiduciary obligations to oversee the quality of the firm's public reports in the interest of facilitating shareholders' ability to make decisions regarding their investments. Because information about material corporate business affairs—and the ability to represent it accurately and credibly to third parties—will continue to be a highly precious commercial asset,28 corporate fiduciary law will continue to evolve standards under the duty of care (and also the duties of loyalty and good faith,29 as discussed hereinafter) for managers' oversight of gathering and reporting this information in both the firm's and shareholders' best interests.

A strong argument can be made, moreover, that the standards governing managers' responsibilities for overseeing their firms' internal control systems and public disclosures should continue to evolve through the process of equitable review.30 The pace of technological and economic change, as such change affects norms of corporate transparency and managerial accountability to shareholders, is likely to exceed the regulatory capacity of comparatively rigid, rules-based systems. The continued development of sound but

28 See, e.g., Carole Basri, Corporate Transparency: The Triple Bottom Line Audit, N.Y.L.J., Sept. 30, 1999 ("In the Information Age the old paradigm of developed and underdeveloped countries, the First World and Third World, no longer exists. In the era of rapid globalization of corporations and financial markets . . . transparency has become the new dividing line.").

29 The distinction between managers' good faith but negligent acts affecting reporting and disclosure and acts in bad faith or in knowing violation of the law will continue to be important in this area, as in other areas of corporate conduct. For example, charter exculpatory clauses, which may insulate directors from good faith but negligent disclosure deficiencies, would not protect directors from personal liability for disclosure deficiencies arising from bad faith or self interest. See Arnold v. Society for Savings Bancorp, 650 A.2d 1270, 1272 (Del. 1994) (concluding directors of corporation did not breach their duty of loyalty or act intentionally in bad faith and thus were exempted from liability due to charter exculpatory clause).

30 For a discussion of the full board's responsibility (in contrast to the somewhat myopic focus on standards for audit committee performance) in overseeing the existence of appropriate and efficacious systems of internal control, see Melvin A. Eisenberg, The Board of Directors and Internal Controls, 19 CARDOZO L. REV. 237 (1997).
parochial rules-based systems, such as the securities laws\textsuperscript{31} and accounting and auditing rules,\textsuperscript{32} should neither supersede the importance nor displace the unique function of corporate fiduciary law in this area. The state courts (and especially the Delaware Court of Chancery), as opposed to federal regulatory agencies, or even private, professional organizations, are uniquely positioned to balance principle (i.e. accountability), context (the legal responsibilities of the relevant corporate officials and the quantity and complexity of the information/systems they oversee) and innovation (such as improved information technologies). These factors will affect the courts' evaluation of the steps corporate directors and officers are expected to take in satisfying their "due diligence" requirement, as a matter of corporate fiduciary law, for ensuring the accuracy of their firms' disclosures. Corporate fiduciary law should operate, optimally, as a supplement to such alternative, rules-based systems in reinforcing "the big picture" in regard to shareholders' rightful expectations of candor, honesty and diligence in managers' administration over disclosure.

Fiduciary law has a distinctive contribution to make in the regulation of managers' participation in disclosure. In contrast to the securities laws' preoccupation with the integrity of "the market," corporate fiduciary law has focused on supporting the integrity of corporate managers as it affects their official behavior. Indeed, corporate fiduciary law has historically had the preeminent role in defining professional standards of conduct for corporate directors and officers vis a vis corporate shareholders. And in applying


corporate fiduciary law to individual cases, courts have not shied away from constructing such standards in terms of expressly personal and moral commitments on the directors' parts. In undertaking this work of *paideia*, corporate fiduciary law (and fiduciary law generally) has assumed some of the "valence" of the criminal law. Although it operates in the adjudication of individual, civil suits, corporate fiduciary law expressly acknowledges the value and fragility of trust as a form of social capital requisite to economic transacting. Thus, it has been the special role, the unique nature and function of corporate fiduciary law to speak expressly to the importance of supporting norms of managerial trustworthiness, and thus shareholders' ability to trust in such trustworthiness.

As applied to corporate reporting, fiduciary law holds the potential to shift the paradigm, as interpreted by the relevant corporate actors themselves, away from the relevant technical formalisms (too frequently hawked by lawyers and accountants) to the more meaningful and trenchant question of whether they would view the disclosure they are involved in crafting as being satisfactorily candid and transparent if it were their own capital at risk. This standards-based, more intuitive heuristic for managers' participation in the disclosure process supplies an important counter balance and complement to federal law's regulation of the precise timing and required topics of corporate disclosure.

It should be noted at this juncture, furthermore, that acknowledging the fiduciary dimensions of managers' participation in disclosure does not require altering the timing or substance of corporate reporting from that prescribed in the highly evolved, unitary federal system. The recognition of the fiduciary dimensions of corporate communications to shareholders does not require that shareholders' informational rights and managers' communicative obligations be regarded as absolute. To the contrary, the fiduciary values of managerial candor and corporate transparency must be reconciled with other, efficiency-driven values affecting corporate disclosure (including firms' need to keep certain information confidential), consistent with the law and also with firms' and shareholders' best interests. Nevertheless, adding fiduciary principles back to the disclosure mix holds the potential to reorient managers' mindset towards their participation in disclosure,
consistent with the aforesaid discussion, in a way that supports enhanced corporate transparency, and thus sustained high levels of equity investment in United States corporations. 33

From a more conventional perspective, corporate disclosure must be studied as an aspect of corporate governance because shareholders cannot exercise their governance rights—including their right to determine whether to hold or to sell their shares on an informed basis 34—with adequate, accurate information about their firms' financial condition and material business affairs. This principle is axiomatic, and indeed self-evident as it relates to shareholder voting. The dysfunctionality of shareholders' rights to vote (which arise under state corporation law), without rights to receive adequate, accurate information (which are afforded public companies' shareholders by virtue of the federal proxy laws and regulations) accounts for why most basic courses, notwithstanding a nod


34 My interpretation of shareholders' hold/sell decisions as being a basic corporate governance right goes to the heart of my disagreement with the Delaware Court of Chancery's opinion in Malone. That opinion described shareholders' governance interests as being relevant to corporate disclosures only where directors have requested some form of shareholder response (that is, in relation to shareholder voting decisions, responses to management communications in regard to tender offer proposals, or in relation to shareholders' exercise of appraisal rights). It failed to include shareholders' ongoing investment decisionmaking—their right to determine on the basis of adequate, accurate information whether to hold (or even to sell) their shares—as an issue of corporate governance. Consistent with the Delaware Supreme Court's decision in Malone, such a view of "corporate governance" is excessively constricted. See Malone v. Brincat, C.A. No. 15510, 1997 Del. Ch. LEXIS 158 (Del. Ch. Oct. 30, 1997), aff'd in part and rev'd in part, 722 A.2d 5 (Del. 1998). The chancery court opinion stated:

In the realm of corporation law, this Court appropriately focuses on issues of internal corporate governance. One of our most important duties is "to protect the integrity of the processes through which shareholders exercise their corporate governance rights and responsibilities." When a board of directors elects or has a duty to seek shareholder action and discloses information in connection with the requested shareholder action, the board's actions implicate the fiduciary duties that attach to the disclosure. . . . When a shareholder is damaged merely as a result of the release of inaccurate information into the marketplace, unconnected with any Delaware corporate governance issue, that shareholder must seek a remedy under federal law.

Id. (citations omitted).
to the concept of "rational shareholder apathy,"35 include a discussion of the federal proxy regulations and the disclosures to shareholders required thereunder.36

Nevertheless, consistent with Albert Hirschman's insights, it is apparent that shareholders protect their interests not only through their voting or "voice" rights, but also, and most crucially in the case of publicly traded corporations, through "exit"—their right to determine on the basis of adequate, accurate information whether to hold or to sell their shares. The hold/sell decision should be acknowledged as a crucial corporate governance right and form of power that shareholders rightfully retain as principals within the corporate fiduciary enterprise.

The elemental significance of shareholders' ongoing autonomy over their capital investment decisions is in no way compromised by the fact that shareholders have delegated administrative authority over their invested capital to the managers, consistent with the fiduciary nature of the enterprise, for the duration of their investment in the firm. Indeed, the ability of shareholders rationally to determine to "exit" the firm (or, relatedly, to determine rationally not to exit at any given time) is the principal corporate governance right that allows shareholders to be "safely passive" in regard to the management of their capital.38 The relatively nonprescriptive, non-shareholder-protective nature of the states' corporation statutes


37 ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

38 See William T. Allen, Ambiguity in Corporation Law, 22 DEL. J. CORP. L. 894, 896 (1997) ("Corporation law facilitates wealth creation principally by creating a legal structure that makes it substantially cheaper for investors to commit their capital to risky ventures. It does this through the innovation of tradeable share interests, centralized management, limited liability, and the entity concept itself. ... Much of this utility depends upon investors allowing themselves to be safely passive."). The innovation of tradeable share interests, of course, is not going to mean much if shareholders cannot rightly determine when it is in their interest to hold or to sell their shares.
reflects both the operation of the (relatively) more shareholder-protective fiduciary laws and, even more significantly, the idea that in rationally choosing whether to hold or to sell their shares in the market, shareholders can "self-protect." Indeed, the open-ended nature of the states' enabling laws has been interpreted as being a direct outgrowth of shareholders' rational, self-interested, market-based choices. Of course, these understandings are premised on the notion that shareholders will be supplied with the accurate corporate information they need to assess their self-interest in terms of holding or selling their shares—and yet, problematically, this information is administered under the authority of rationally self-interested corporate actors. The argument for robust enforcement of fiduciary standards in relation to managers' participation in disclosure is, on this basis, stronger than it is in relation to self-dealing transactions, for example, where the market (in the absence of information-failure) may itself exert a prophylactic effect. In any case, the present system of corporation laws contemplates that the firm's managers obtain authority to determine what should be done with the capital shareholders have elected to invest within the firm (consistent with maximizing the corporate entity's and shareholders' financial interests)—it does not properly afford managers sovereignty over the shareholders' ongoing investment decision itself.

In summary, shareholders' right to determine on an informed, rational basis whether to keep their capital invested in the firm or to divest it therefrom is a fundamental aspect of the corporation laws and corporate governance system that operate on behalf of shareholders in public companies, despite the fact that it has rarely

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40 See Blasius Indus. v. Atlas Corp., 564 A.2d 651, 663 ("The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters."). The distinction is at the heart of the ongoing controversy surrounding corporate managers' ability to thwart shareholders from selling into high-value, non-coercive tender offer bids consistent with managers' obligation to be loyal to shareholders' interests. For an excellent discussion of the propriety of directors' attempts to thwart joint proxy contest/tender offers, see Randall S. Thomas, Judicial Review of Defensive Tactics in Proxy Contests: When is Using a Rights Plan Right?, 46 VAND. L. REV. 503 (1993).
expressly been discussed as such. From a normative perspective, the affirmation by courts of equity of shareholders’ continued autonomy over their investment decision functions to reaffirm shareholders’ status as principals within the corporate fiduciary relation, and thus to check the abuse of managerial power. From a positive and market-oriented perspective, shareholders’ ability to choose, on the basis of adequate, accurate information, whether to hold or to sell their shares is the operative mechanism by which the capital and takeover markets promote managerial accountability and thus influence corporate governance for the better.

Proxy disclosures relevant to shareholder votes are, thus, only one variable in the informational equation of shareholders’ rights and managerial power. Shareholders’ decisionmaking regarding whether to retain their investment within the firm also is affected significantly by corporate disclosures publicized through periodic reports (SEC filings on forms 10-K, 10-Q and 8-K), corporate press releases, and the annual report to shareholders mandated by SEC Rule 14a-3. Shareholders rely on the full complement of official public disclosures made by publicly traded firms, and are affected by them, even where they omit a direct review of the relevant documents, since important new information disclosed therein is digested, analyzed and circulated by brokers, analysts and an

41 Commentators have discussed the importance of shareholders’ “right to exit” the firm through a sale of their shares (as a response to unsatisfactory corporate performance) as a tool of managerial discipline (as it facilitates hostile tender offers and the ouster of underperforming managers). Nevertheless, besides noting that the “transferability” of corporate shares is a basic feature of the corporate form of organization, commentators and courts have generally failed to note that the right to make an informed hold/sell decision is an essential right of shareholders within corporation law. This is evidenced, for example, by the fact that there is no convenient or accepted term for describing this “right.”

42 Although the notion of shareholders’ “autonomy” over their invested capital is underexamined within corporate fiduciary law, it may be understood to be a component of the “fair dealing” requirement that applies to freeze-out mergers, for example. See Emerald Partners v. Berlin, 726 A.2d 1215, 1223 (Del. 1999) (finding fact issue on element of fair dealing foreclosed dismissal); Kahn v. Lynch Communication Sys., Inc., 669 A.2d 79 (Del. 1995) (addressing fair dealing standard in relation to questions of candor and disclosure to shareholders).

43 For the argument that capital market signals facilitate the ability of corporate managers to promote corporate competitiveness, see Jeffery N. Gordon, The Shaping Force of Corporate Law in the New Economic Order, 31 U. RICH. L. REV. 1473, 1479 (1997).
expanded financial media operating through print, television, radio, and web-based formats.

Put simply, bad news travels fast, but corporate managers' disclosure of erroneous favorable information short-circuits this process. Without such accurate information, shareholders cannot seize the opportunity to exert informal pressure on existing management as a means of addressing their firms' problems. In terms of formal action, shareholders will not be motivated to install a new, potentially more dynamic, creative or competent board if they are being told that the firm's performance and prospects are "on target." And certainly, in many instances, shareholders might elect to sell their shares, in the attempt to minimize their losses, if information about diminished profitability or worsened prospects were disclosed. But even more universally, where managers' presentation of erroneously favorable information has deprived equity holders of their capacity for rational decisionmaking vis-à-vis their invested capital, such injury should be compensable, in at least nominal terms, independent of the attempt to quantify their damages, ex post, in relation to their stock's trading price at some earlier, hypothetical time of sale.

Incorporating the discussion of shareholders' informational dependence upon corporate managers into the discussion of the

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44 See Jeffrey N. Gordon & Lewis A. Kornhauser, Efficient Markets, Costly Information, and Securities Research, 60 N.Y.U. L. REV. 761, 787 (1985) (stating "the efficient market hypothesis should be imbedded in a general model that simultaneously explains both investors' decisions to acquire information and the process of market aggregation of information held by investors"). My understanding is that the process of investment information acquisition by various shareholders (e.g., individuals versus institutions) is under-observed within the basic course and even the literature on corporate governance, at least outside of the public offering context.

45 The case law and commentary has thoroughly observed shareholders' dependence upon managers in relation to the maximization of the value of the capital that the shareholders have invested in the firm, but their informational dependence upon managers' good faith, diligent participation in the disclosure process has only recently begun to be observed in the fiduciary case law—most particularly, within Delaware's doctrine of directors' "disclosure" duties. My argument with this line of cases is that it has marginalized and trivialized the question of honesty and candor in directors' communications to shareholders by unreflectively tying the resolution of the question of fiduciary law's relevance to corporate disclosure to the presence or absence of a request for a shareholder action. Rather than the formalism of the board's request for a shareholder action, it is shareholders' fundamental, systematic informational dependence on their firms' managers—in conjunction with their need for accurate information as a basis for exercising their corporate governance rights—that
agency costs with which corporation law is centrally concerned and focusing on managerial diligence, honesty and good faith in administering the disclosures material to shareholders as an important facet of corporate governance would, admittedly, involve a significant reorientation in the established boundary between state corporate and federal securities law—one that would have significant implications for the teaching of corporation law. Because the federal securities laws and regulations define the reporting system operating in public companies, and because the federal securities laws have historically been of preeminent importance in defining private causes of action for investors seeking recovery for losses caused by corporate misrepresentation, the constitutes the basis for applying fiduciary principles to managers' participation in disclosure to shareholders. For the leading historical analysis of the (state law fiduciary) doctrine of directors' duty of "disclosure" or "candor," see Lawrence A. Hamermesh, Calling Off the Lynch Mob: the Corporate Director's Fiduciary Disclosure Duty, 49 VAND. L. REV. 1087 (1996). The delegation of broad, discretionary authority and the undertaking on the beneficiary's part of assumed dependence is a signal feature of fiduciary relations, of course. See Tamar Frankel, Fiduciary Law, 71 CAL. L. REV. 795, 808-09 (1983) (describing "anatomy" of fiduciary relations).

An examination of corporate disclosures made through press releases and periodic reports, and its implications for current shareholders and other market participants, could conveniently be integrated into the basic Corporations course after the discussion of the SEC's proxy regulations. For an integrated discussion of federal and state law approaches to disclosure, as they affect shareholders' interests, see LEWIS D. SOLOMON ET AL., CORPORATIONS, LAW AND POLICY 827-93 (4th ed. 1998) ("If fiduciary duties are one of the critical elements in the relationship between shareholders and management, it fairly may be said that disclosure lies at the heart of much of the law of fiduciary duties.").


For several decades, the bulk of investor suits alleging informational fraud have been brought under section 10(b) of the 1934 Act and SEC Rule 10b-5 thereunder. (It is noteworthy that Rule 10b-5 is routinely described as "a judicial oak which has grown from little more than a legislative acorn." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)). After the passage of the Private Securities Litigation Reform Act, there was at least the perception that there were more widespread attempts to employ state securities law and common law fraud doctrines (as well as, most recently, fiduciary norms) as the bases for shareholder suits alleging losses arising from corporate fraud. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified at 15 U.S.C. §§ 77k-1, 77z-1 to z-2, 78u-4 to u-5, 78j-1 (Supp. II 1996)). This development was addressed by Congress in its enactment of the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227. For commentary on the latter, see Richard W. Painter, Responding to A False...
primary legal development and study of the problem of corporate (mis)disclosure has fallen outside the traditional boundary of state corporate law and thus the traditional curriculum of the basic Corporations course.

Interestingly, this particular question—the proper domain of state corporate versus federal securities law in regulating corporate disclosure to shareholders—was addressed recently by the Delaware Court of Chancery and later the Delaware Supreme Court in *Malone v Brincat.* Malone involved a claim for breach of fiduciary duty against the directors of Mercury Finance Corporation, a company traded on the New York Stock Exchange whose business focused on purchasing installment sales contracts on automobiles. The shareholders alleged that the company's directors knowingly overstated the firm's earnings and shareholders' equity in virtually all of the Securities and Exchange Commission filings and public reports made by the company over a four-year period. Although formally brought under the relatively recently recognized doctrine of directors' "fiduciary duty of disclosure," the gravamen of the complaint was that the deliberate misrepresentation on the part of the directors as corporate fiduciaries constituted a more general, fundamental breach of their fiduciary obligations to their shareholders. The simplicity of the plaintiffs' claim was its genius: How could the directors lie to the shareholders, on the facts alleged, and yet be loyal to furthering their best interests?
Nevertheless, notwithstanding the compelling nature of the plaintiffs' claim, the chancery court held that the shareholders had failed to state a cause of action, and granted the defendants' motion to dismiss with prejudice.\textsuperscript{54} The chancery court based its holding on its interpretation of Delaware's case law validating an express "request for shareholder action" as a prerequisite for the application of "directors' fiduciary duties of disclosure."\textsuperscript{55} In broad-sweeping language the chancery court opined that fiduciary obligations and matters of corporate governance were simply not implicated—\textit{even if the directors had made deliberate material misrepresentations in the relevant disclosures}—since the complained-of disclosures contained no express request for a shareholder action.\textsuperscript{56} But stare decisis was not, ultimately, the decisive factor driving the court's opinion. Federal \textit{securities} law, according to the court, not state corporate \textit{fiduciary} law, provided the proper basis for allegedly

\textsuperscript{54} Malone, 1997 Del. Ch. LEXIS 158, at *1 ("Director defendants, in a Motion to Dismiss pursuant to Court of Chancery Rule 12(b)(6), contend that no duty to disclose arose under Delaware law because the directors did not release the financial statements in connection with a request for shareholder action. I agree and therefore grant the Motion to Dismiss, with prejudice.").

\textsuperscript{55} Id. at *6 ("This court has stated on numerous occasions that, absent a request for shareholder action, no fiduciary duty of candor arises under Delaware law."). The court's allusion to the unsettled nature of the law (in terms of the absence of Supreme Court authority on the point) and the begrudging tone of the opinion suggest that stare decisis was not the decisive factor behind the court's grant of the defendant's motion to dismiss, however. See \textit{id}. at *8 ("Neither the Delaware corporation code nor the common law suggests that Delaware can or should pick up the perceived regulatory slack when federal scrutiny may not include review of every actionable theory divinable by a dogged plaintiff.").

\textsuperscript{56} Id. The outcome of the case was motivated by the court's excessively narrow, but not wholly unconventional, interpretation of the scope of corporate governance. As described herein, commentators have largely overlooked shareholders' need for accurate information as the basis of their making informed hold/sell decisions \textit{vis-a-vis} their shares.
defrauded shareholders to seek redress for losses they had suffered as investors in Mercury Finance. However, consistent with the previous discussion of market-based corporate governance mechanisms, such a distinct analytic separation between "the firm" and "the market"—with corporate law governing the former and securities law the latter—is overly formalistic and untenable.

Moreover, as the chancery court in Malone also failed to discuss, the federal securities laws do not protect defrauded holders of corporate shares, or "nonsellers" in the language of securities law. Because the Blue Chip rule bars "nonsellers" from bringing a cause of action under federal law, the plaintiffs in Malone could not have proceeded with a cause of action under Rule 10b-5.

Ultimately, it was the formalistic and excessively narrow parameters drawn around the definition of shareholders' corporate governance rights that invited the reversal of the chancery court's Malone decision. The definition of corporate governance employed by the court in Malone was simply unacceptably constrained. Knowing misrepresentation on the part of corporate managers of material corporate information that is foreseeably of importance to shareholders' voting and investment decisionmaking—particularly where such material misrepresentations present an erroneously favorable view of the firm's and, thus, the managers' own performance—is as much an agency cost problem, and thus a proper subject of "corporate governance," as is managerial misappropriation of corporate property. As stated earlier, notwithstanding the

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57 Id. at *7-8.
58 Strangely, the opinion remarks that only federal law is applicable to the "misdisclosures" under consideration, while it acknowledges, at the same time, that federal law may not provide a cause of action to the plaintiffs at bar. Id. at *8 ("[F]ederal scrutiny may not include review of every actionable theory divinable by a dogged plaintiff."); see also Transcript of Oral Argument Before the Supreme Court of the State of Delaware at 6, Malone (No. 459) ("Mr Prickett: First of all, as to the federal law, generally it's buyers or sellers in this context, and we are not talking about buyers or sellers. The class I represent are people who just held stock in Mercury and didn't change their position. They didn't buy in, and they didn't buy out.").
federal role in the disclosure area, state corporate fiduciary law has had the preeminent role in responding to the vulnerability of holders of corporate shares by promulgating broad-based, explicitly normative standards for managers' conduct of corporate affairs in the shareholders' best interests.61 And because shareholders' best interests include being accurately informed about corporate affairs so that they are afforded a basis for their rational decisionmaking, managers' fiduciary duties must be understood to apply to the full panoply of official corporate disclosures routinely made by public corporations.

The Delaware Supreme Court's reversal of the chancery court's decision in Malone validates the idea that shareholders' informational needs, whether they relate to voting their shares or determining whether or not to continue to hold them, are core concerns of corporate fiduciary law and corporate governance that should occupy students' attention within the basic Corporations course. However, in light of the working premise that corporate investors are motivated chiefly by the objective of profit maximization, the academic and classroom discussion of the duty of loyalty has focused on the problem of managerial self-dealing in corporate property.62 Yet the concept of corporate fiduciary loyalty is surely broader than the prohibition on managerial expropriation.63 And, moreover, while a commitment to facilitating shareholders' free decisionmaking vis-à-vis potential sales of control is reflected in the jurisprudence of target company managers' fiduciary duties, the conceptual basis of that fiduciary obligation has remained inchoate in the cases and commentary. If the ability to generate long term shareholder value is linked to the maintenance of social, cultural and moral values


62 See supra note 9 and accompanying text.

63 See Brudney, supra note 4 (describing uniqueness of fiduciary (loyalty) standards in contrast to contract-based norms).
such as "loyalty," as social science research increasingly suggests, then students of corporation law may too frequently have been indoctrinated into an insufficiently developed conception of fiduciary loyalty.

Corporate managers' duty of loyalty to shareholders does, of course, encompass a commitment to further the prescribed objectives of the corporate fiduciary enterprise in the interest of the shareholders (i.e., corporate profit maximization, as traditionally defined). But managers' duties of loyalty to shareholders also encompass an obligation on the managers' part to respect the limits of the authority delegated to them (this is the conceptual basis of the prohibition on directors entrenching themselves in office, as it is enforced in the takeover cases).64 Finally, consistent with the focus in this Essay, as fiduciaries for their shareholders, corporate managers must respect and facilitate the forms of autonomy and authority that shareholders rightfully retain within the corporate fiduciary enterprise, as part of their duty to be loyal to the shareholders' interests. This principle is the basis of the fiduciary dimensions of managers' informational responsibilities as they affect shareholders' voting and investment decisionmaking. In fact, a glance beyond corporate fiduciary law suggests that an obligation to account and, a fortiori, to account honestly, for the outcome of the given fiduciary enterprise is endemic to the obligations that fiduciaries owe their beneficiaries.65 Thus, corporate managers owe an obligation of trustworthiness, candor and diligence in their oversight of disclosure to their shareholders, consistent with their fiduciary loyalty obligation to respect shareholders' rational, free decisionmaking power.

Therefore, in declaring that corporate managers violate basic fiduciary principles of loyalty and good faith if they deliberately publish material misrepresentations in public disclosures or direct communications to shareholders, and in allowing the Malone plaintiffs to replead their claim on this basis, the Delaware Supreme

64 For reference to the relevant case law, see supra note 10.

65 See, e.g., RESTATMENT OF TRUSTS § 173 ("The Trustee is under a duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property.").
Court "got it right." At least, in determining to hear the appeal en banc, the court appears to have realized the elemental significance of the issue before it.\(^6\) Rather than a narrow doctrinal question in the area of directors' so-called "duties of disclosure," it was the norm of managerial honesty within corporate fiduciary loyalty that was on the line in\(^\text{Malone}.\) In simple terms, the Delaware Supreme Court's decision affirmed authoritatively that lying by corporate fiduciaries is "egregious":\(^6\) it injures not only the financial interests of the shareholders directly involved and the efficient operation of the securities markets, but also the storehouse of communal trust that is a prerequisite to corporate equity investment.\(^6\)

Yet, this Essay's endorsement of the Delaware Supreme Court's holding in the\(^\text{Malone}\) case is subject to two major caveats. Most significantly, the Delaware Supreme Court's opinion indicates, indirectly, that shareholders proceeding with a cause of action for "fiduciary misrepresentation"\(^6\) will be required to prove their individual reliance on the allegedly false disclosures,\(^7\) in addition to other elements of the cause of action. Accordingly, if this aspect

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\(^6\) Transcript of Oral Argument Before the Supreme Court of the State of Delaware, Malone v. Brincat, No. 459, 1997, at 12 (Feb. 18, 1998) ("Chief Justice Veasey: Is this a case of first impression? ... Do you think we should go en banc to hear this case, or do you think this panel can decide it?").

\(^7\) Malone v. Brincat, 722 A.2d 5, 8 (1998) ("[T]hese violations of fiduciary duty, which (if true) are egregious."); see also Norman E. Veasey, The Defining Tension in Corporate Governance in America, 52 BUS. LAW. 393, 406 (1997) ("In the end the issue is integrity. Corporate governance depends on the integrity of directors and their counselors.").

\(^6\) There is an evolving literature on the importance of trust to economic interactions. See, e.g., Bruce Chapman, Trust, Economic Rationality, and the Corporate Fiduciary Obligation, 43 U. TORONTO L. J. 547 (1993) (arguing for importance of trust in realm of competitive corporate contracting); Oliver Williamson, Calculativeness, Trust, and Economic Organization, 36 J. L. & ECON. 453 (1993) (elucidating notion of trust as relevant to economic transacting).

\(^6\) The coinage is my own.

\(^7\) Malone, 722 A.2d at 23. Rather than addressing the question of proof of individual reliance head on, the court merely stated that the plaintiffs should have the opportunity to replead as "a properly recognizable class consistent with Chancery Rule 23, and our decision in Gaffin." Id. at 14. The Gaffin case is cited in Malone for the principle that "a class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact." Id. at 14 n.47; Gaffin v. Teledyne, Inc., 611 A.2d 467, 474 (1996). My view is that the disposition of power within the corporate fiduciary relationship mandates an altered approach to the reliance requirement—one more favorable to the plaintiffs.
of Malone holds true in future decisions, such suits for fiduciary misrepresentation will generally be barred from proceeding as class actions. From the perspective of compensation, the possibility of consolidated individual actions of groups of defrauded institutional investors is, clearly, only a partial response to the problem of managerial misrepresentation\textsuperscript{71}—one obviously unresponsive to the concerns of defrauded individual holders (who, it is important to recall, are unprotected by a federal cause of action and barred from pursuing state common-law fraud suits on a class basis).\textsuperscript{72}

Secondly, from the perspective of deterrence, Malone appears to represent a gamble on the Delaware Supreme Court’s part that it can uphold the persuasive, paideutic function of corporate fiduciary law\textsuperscript{73} in a world of manager-friendly burdens of proof and limited economic sanctions. The Supreme Court’s Malone decision states unequivocally that “shareholder constituents of a Delaware corporation are entitled to rely upon their elected directors to discharge their fiduciary duties at all times;\textsuperscript{74}” and that “shareholders are entitled to rely upon the truthfulness of all information disseminated to them by the directors they elect to manage the corporate enterprise.”\textsuperscript{75} But one must be skeptical of the significance of such an “entitlement” where shareholders who have suffered a loss while they continued to hold their securities in enforced ignorance of the true condition of the firm and have demonstrated the materiality of the misrepresentations made knowingly or in bad faith by their director-fiduciaries are neverthe-

\textsuperscript{71} See John C. Coffee, Jr., Disclosure Duties, New Law and New Issues, N.Y.L.J., Jan. 21, 1999, at 5 (“In the case of false statements not intended to secure or induce shareholder action, the plaintiff would need to prove reliance, causation, and damages in addition to materiality. But it is possible to imagine a consortium of large investors, particularly including angry institutional investors, who might file such actions on a consolidated basis, possibly sharing a common counsel.”).


\textsuperscript{73} “Paideutic” is the adjectival form preferred by Werner Jaeger. WERNER JAEGEr, PAIDEIA (1944). But “paideic” is also used. For the latter, see Robert Cover, Nomos and Narrative, 97 HARv. L. REV. 4, 25 (1983) (describing Bible as the “paideic center of the interpretive traditions that grew from it”).

\textsuperscript{74} Malone, 722 A.2d at 10 (emphasis added).

\textsuperscript{75} Id. at 10-11 (emphasis added).
less denied a recovery absent their proof of individual reliance upon the misrepresentations.

It is far from clear that corporate fiduciary law can continue to communicate the gravity of the norm of managerial honesty that inheres therein or to support the trust of investors that assumes the operation of such honesty—especially once the question of managerial mendacity has been presented to corporate fiduciary law as nakedly as it was in Malone—while taking such a hard line on shareholders' burden for establishing a recovery. Surely some separation between standards of conduct and standards of review is acceptable, and even desirable,76 and there is no mistaking the difficulty of the damages question presented therein, but there is clearly a danger that the Delaware Supreme Court's opinion in Malone will come to represent a kind of formalism or even judicial disingenuousness toward corporate fiduciary law that may ultimately undermine respect for this body of law, and thus its efficacy.

The Malone decisions thus provide a fruitful context for examining both corporate fiduciary law's unique role in articulating normative standards of professional conduct for corporate directors and senior executive officers and, also, for considering what it will mean to managers, shareholders, and our "information"-based society if state courts refuse to back the norm of honesty inherent within corporate fiduciary law with meaningful, realistically enforceable legal sanctions.

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76 Eisenberg, supra note 18; see also James D. Cox, The Social Meaning of Shareholder Suits, 6 BROOK. L. REV. 3 (1999) (arguing for reforms designed to underscore deterrence-related, socially significant features of shareholder suits, including requiring appropriate, individual corporate actors to pay portion of judgment or settlement awarded).