AFTER *ENRON*: REMEMBERING LOYALTY DISCOURSE IN CORPORATE LAW

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ABSTRACT

The demise of monetary damages as a remedy for breach of the corporate director duty of due care means that only a breach of the duty of loyalty or good faith affords the possibility of holding corporate directors personally liable for wrongdoing. The author argues that the fiduciary duty of loyalty contains both a widely-appreciated, but rather minimal, "non-betrayal" aspect and a less-appreciated, but more affirmative, "devotion" dimension. The affirmative thrust of loyalty, grounded in widely-shared cultural norms and finding expression in myriad literary and religious stories, offers a doctrinal avenue for addressing a potentially broader range of director misconduct than is commonly thought.

In a post-Enron world of corporate governance scandal and calls for reform, fiduciary duty law presents, as a policy matter, a possible state law-based approach for attaining greater director accountability. The wisdom of doing so will depend, in part, on whether the risk of greater financial exposure will induce enhanced discharge of director responsibilities, to the advantage of shareholders, or dissuade capable prospective director candidates from service, to the detriment of shareholders. At a more theoretical level, understanding the affirmative facet of both the social norm of loyalty and the legal duty of loyalty raises deeper questions such as whether the supposed conceptual distinction between "care" and "loyalty" is as clear as widely believed and whether corporate law fiduciary discourse should continue to be conducted in moral-sounding terms at all. This, in turn, depends on whether we sensibly conceive of

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directors as being moral actors and regard corporate relationships as raising moral issues, rather than just economic/financial issues for which a new (or re-loaded) discourse might be more suitable.

The article closes by addressing how judges—to whom both the practical and the policy-theory issues have fallen—might explore the fuller reaches of loyalty. The article coins the notion of "due loyalty" to express the appropriate, context-sensitive demands of loyalty understood as devotion.

"[L]oyalty is an essential ingredient in any civilized and humane system of morals."[1]

"[M]any younger girls did not understand the word [loyal]; older girls and adults asked 'loyal to what?'"[2]

"Of all the virtues presumed to have been lost in America, loyalty generally takes pride of place."[3] "No other institution . . . provokes such bittersweet reflections of loyalty lost as the business corporation."[4]

I. INTRODUCTION

Modern corporate law has inherited, but risks squandering, a rich, moral vocabulary. The cardinal notions of "care" and "loyalty" carry—or did carry—profound social, philosophical, and literary meaning outside corporate law discourse. When used to describe director fiduciary duties within contemporary corporate law discourse, however, those core terms often impart remarkably little of that same richness. One result is the tragic Enron story, which with the passage of time will be seen as a failure of corporate governance, that is, a failure of care and loyalty.

Today, the duty of care serves as only a very weak substantive constraint on director conduct and is spoken of in unusually shrunken terms.[5] With respect to the duty of loyalty—now receiving renewed attention precisely because of care's dramatic decline—one likewise wonders whether in the years ahead this baseline duty will bear any lexical

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[1]JOHN LADD, *Loyalty*, *in* 5 ENCYCLOPEDIA OF PHILOSOPHY 97 (1967).

[2]Girl Scouts of the USA, *National Council Meeting Workbook/Guide* (New York: Girl Scouts of the USA, 1972) 24, *quoted in* JAMES DAVISON HUNTER, THE DEATH OF CHARACTER 72 (2000). In 1972, the Girl Scouts deleted from their handbook the requirement that a scout be "loyal."

[3]ALAN WOLFE, MORAL FREEDOM 23 (2001). Professor Wolfe is a noted sociologist.

[4]*See id.* at 26.

[5]*See* Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787, 788-89 (1999).

resemblance to its historical, moral counterpart. Perhaps, as with care, it will be drained of any genuinely arduous demands. Or, following the Girl Scouts' example in 1972, corporate law authorities may discard the notion altogether after concluding they do "not understand the word."[6] Perhaps too, Enron is not a unique story of loyalty lost, but a symptom of a deeper, more endemic corporate failing.

This article focuses on the state of, and possibilities for, loyalty discourse in corporate law. Tragedy, whether in corporate life as seen in Enron, or in our larger social life as seen on September 11, invites deep reflection. The article is an argument that, after Enron, we should remember the quality of loyalty and reclaim it as central to corporate well-being. It does not do so by arguing that Enron is a story of failed loyalty—though existing evidence points that way—because the complicated facts of that debacle are still unfolding. Instead, the article proceeds by drawing a portrait of loyalty as it has been, and is now, both in corporate law and in our larger social milieu. With such a picture of loyalty in mind, we may ask whether the malaise in corporate culture—including Enron but extending far beyond it—signifies a serious but still remediable regulatory failure or a more basic and troubling moral failure. This deeper inquiry requires a portrayal of what loyalty discourse looks like in corporate law today, what it has looked like in the past, and what it could look like in the future.

The article begins by identifying why the duty of loyalty has emerged as so critical at this moment in corporate law, both in judge-made legal doctrine and potentially in scholarship. On the scholarship front, after twenty-five years of largely being colonized by the law and economics perspective, a new found interest in social norms is emerging.[7] This exploration of norms in corporate governance requires a vocabulary. To actually affect corporate doctrine and practice, this vocabulary should be accessible to, and widely shared by, the key institutional actors—judges, directors, and lawyers. Due to its fluid and open texture, along with its historic roots in corporate law discourse, the norm of loyalty can link the new doctrinal debate over the dividing line between care and loyalty with the emergent scholarly inquiry into how norms in the larger social-moral milieu shape, and are shaped, by corporate law.

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[6]*See supra* note 2 and accompanying text.

[7]*See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1254-55 (1999); Symposium, *Norms and Corporate Law*, 149 UNIV. PA. L. REV. 1607 (2001); *see generally* Robert Ellickson, *Law and Economics Discovers Social Norms*, 27 J. LEGAL STUDIES 537, 538-39 (1998) (noting the impact of legal scholarship on social norms); Symposium, *The Legal Construction of Norms*, 86 VA. L. REV. 1577 (2000) (commenting on a number of social norms which regulate civic acts, and the economic internalization affecting these civic acts).

The article next explores whether the contours of loyalty in corporate law are, or ever have been, either especially clear or as narrowly confined as many imagine. Disparate philosophical meanings of loyalty are sketched, ranging from a minimalist aspect of *nonbetrayal* to the more full-bodied dimension of affirmative *devotion*. The inevitable way in which loyalty as devotion intersects the crucial concept of care—thereby complicating ongoing judicial efforts to differentiate these core notions—is addressed next. That innate overlap invites the basic question of whether a moral vocabulary, comprised of overtly normative words like "care" and "loyalty," should still be used in contemporary corporate law discourse. The continued value of moral language depends upon whether corporate law conceives of directors as full-fledged moral actors (for whom moral language makes sense) or as one-dimensional economic functionaries (for whom moral language makes little sense). Closely linked to this issue is corporate law's still-unresolved stance on a longstanding concern—the nature of social bonds within the corporation. If such bonds are best envisioned as predominantly bargained-for in nature, then corporate law's inherited moral vocabulary is either best discarded in favor of more instrumental terms, or as with care, refashioned so as to be morally innocuous. Alternatively, if directors are understood as embedded in a social-historical-moral milieu not entirely of their own making, then the use of traditional moral terms to describe their duties is still warranted.

The final part of the article links loyalty discourse to the interpretive, policy, and doctrinal facets of judging. It closes on a pragmatic note by coining the notion of "due loyalty." This suggested doctrinal phrase is designed to promote creative—but still disciplined and historically faithful—discourse about where and how to draw the decidedly unsettled boundaries of loyalty in modern corporate law. Knowing what loyalty is and has been, we can decide, after Enron, what its place should be in future corporate life.

II. WHY CLASSIFYING DIRECTOR MISCONDUCT MATTERS

The fiduciary duty of corporate directors includes a duty of care and a duty of loyalty.[8] The financial consequences of breaching these two duties, however, are quite different. After several prominent directors in 1985 were held personally liable to shareholders for breach of care in the high-profile case of *Smith v. Van Gorkom*,[9] the Delaware legislature quickly

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[8] *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985); E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 397 (1997).

[9] 488 A.2d 858 (Del. 1985).

adopted a statute permitting the charters of Delaware corporations to limit or eliminate director liability for monetary damages arising from fiduciary duty breaches.[10] This statutory limitation is subject to four specified exceptions where personal liability remains.[11] Since the four exceptions do not include the duty of care,[12] corporate charters may exculpate directors from monetary liability for breach of this baseline duty.[13] It now is quite common for charters of Delaware corporations to provide such exoneration.

The upshot of this development is that aggrieved stockholders seeking damages must now convince a court that director misconduct is not solely classifiable as a breach of care,[14] but is behavior falling within one or more of the four statutory exceptions permitting money damages.[15] One

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[10]*See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1991 & Supp. 2000). Exculpation under the statute belongs to individual directors, not the board as a whole, and thus must be determined on a director by director basis. *In re* Student Loan Corp. Deriv. Litig., No. 17,799, 2002 Del. Ch. LEXIS 7, at *13 n.8 (Del. Ch. Jan. 8, 2002).

[11]DEL. CODE ANN. tit. 8, § 102(b)(7) (1991 & Supp. 2000). Equitable remedies are unaffected by this statute and therefore a proven breach of the duty of care can result in the grant of equitable relief. Other states quickly followed Delaware's lead. By 1986, over thirty states already had adopted similar, or even stronger, laws. *See* Douglas M. Branson, *Assault On Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375, 381 & n.30 (1988).

[12]In pertinent part, section 102(b)(7) provides as follows:

> § 102. Contents of Certificate of Incorporation
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> . . . .
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> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
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> . . . .
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> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit . . . .

DEL. CODE ANN. tit. 8, § 102(b)(7) (1991 & Supp. 2000)

[13]*See, e.g.*, Rosser v. New Valley Corp., No. 17,272, 2000 Del. Ch. LEXIS 115, at *26 (Del. Ch. Aug. 15, 2000).

[14]Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) (providing that section 102(b)(7) charter provision "bars the recovery of monetary damages from directors for a successful stockholder claim that is based exclusively upon establishing a violation of the duty of care").

[15]Numerous recent decisions in Delaware address the classification of director wrongdoing issues for this reason. *See, e.g.*, Grace Bros. Ltd. v. Uniholding Corp., No. 17,612, 2000 Del. Ch. LEXIS 101 (Del. Ch. July 12, 2000), *reprinted in* 27 DEL. J. CORP. L. 304 (2002); O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 915 (Del. Ch. 1999). The Delaware Supreme Court has indicated that directors must raise § 102(b)(7) as an affirmative defense and

of the exceptions pertains to a breach of the duty of loyalty[16] and another pertains to acts or omissions not in good faith. Plaintiff-stockholders, therefore, understandably seek to broadly characterize director conduct as violating the duty of loyalty or good faith, arguing for an expansive reading of these notions.[17] On the other hand, defendant-directors argue that loyalty is a tightly circumscribed concept and that stockholder grievances implicate only the duty of care, thereby precluding damages.

Theoretically, at its most ambitious, the stockholder project would aim to subsume many, if not most or all, of the obligations imposed by "care" under the rubric of "loyalty." This is best achieved by a two-fold strategy. First, shareholders might argue, the duty of care should be accorded a narrow scope, thereby leaving all other fiduciary demands for the residual domain of loyalty. Second, it might alternatively be suggested that loyalty encompasses care, that one cannot truly be loyal without care, and that the *concept* of care remains an integral part of corporate law through the *doctrine* of loyalty.[18] This is an attractive and philosophically compelling position. At the same time, however, it is a dangerous strategy because it risks a rhetorical obliteration of any conceptually sharp boundary line between care and loyalty—two notions often thought to occupy separate spheres.

Opposing views on director liability require a judicial determination as to whether a complaint's allegations essentially raise care or loyalty

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bear the burden of establishing each of its elements. McMullin v. Beran, 765 A.2d 910, 926 (Del. 2000) (citing Emerald Partners v. Berlin, 726 A.2d 1215 (Del. 1999)). For a collection and discussion of Delaware decisions dealing with director liability in the year 2002, see William D. Johnston & Dawn M. Jones, *Director Liability and Indemnification in American Bar Association*, REV. DEV. IN BUS. & CORP. LITIG. 2002 (2002). No decisions in 2002 granted pretrial dismissal of all claims based on a section 102(b)(7) charter provision.

[16]*See supra* note 12.

[17]Although this article addresses loyalty, another exception to director exculpation is absence of good faith. Concern about director misconduct of a sort thought to be appropriate for the sanction of damages might be characterized as a "loyalty" breach or a "good faith" breach. Recently, Chief Justice Veasey has suggested that lack of good faith might be a fitting characterization of certain director conduct.

> [I]f directors claim to be independent by saying, for example, that they base decisions on some performance measure and don't do so, or if they are disingenuous or dishonest about it, it seems to me that courts in some circumstances could treat their behavior as a breach of the fiduciary duty of good faith.

E Norman Veasey, *What's Wrong with Executive Compensation?*, HARV. BUS. REV. 11, 76 (Jan. 2003). *See also* Leo E. Strine, Jr., *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 BUS. LAW. 1371, 1385-86, 1393-95 (2002) (discussing good faith).

[18]This is an ironic example of a social norm—care—finding expression through a legal doctrine—loyalty—with which it is often contrasted.

charges.[19] In addressing this question, lawyers and judges, for the first time in corporate law, must give sustained attention to identifying the key qualities of loyalty, e.g., as well as stating with precision whether and how that duty differs from, or overlaps with, the duty of care.[20] This taxonomic endeavor is quite new, and represents a surprisingly complex and significant chapter in corporate law. As usual in corporate law,[21] this chapter is quietly being written by corporate lawyers and the judges of the Delaware Chancery[22] and Supreme Courts. Unfortunately, however, this newly-emerging issue in corporate law is being addressed with relatively little scholarly input, and with no visible effort to enrich the dialogue by drawing upon what loyalty means in the wider social-philosophical and literary realms of discourse. Grounding contemporary corporate law's understanding of loyalty both in larger, social-normative treatments of that concept, and in corporate law's own historic renderings of that notion, can enhance an appreciation of loyalty's full potential. This is now critical for corporate law for three reasons. First, judges must give the word "loyalty" in the text of section 102(b)(7) and similar state statutes an authoritative interpretation. Second, the waning of care places enormous significance on whether loyalty is a norm/duty sufficiently robust and fluid that it can fulfill the ongoing demands that corporate law still entrusts to fiduciary duty. Finally, the aftermath of Enron, with charges of betrayal and disloyalty, invites the rethinking of loyalty both as a corporate law duty and as a widely shared social norm.

A. *Is The Meaning of Loyalty Clear?*

The word "loyalty," like many words commonly used—such as "good," "fair," "tender"—seems clear in meaning until we are pressed to define it or say whether in a particular instance it was or was not present.

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[19]*See, e.g.*, *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 728 (Del. Ch. 1999), *aff'd sub nom.* Walker v. Lukens, Inc., 757 A.2d 1278 (2000) (order) (stating that "[t]he presence of the section 102(b)(7) provision in the Lukens charter thus causes me to inquire, at the threshold, into the nature of the breaches of the fiduciary duty alleged in the Complaint").

[20]As suggested earlier, *supra* note 17, some might prefer to augment the notion of "good faith" rather than loyalty, to stand in contrast to the duty of care.

[21]*See* Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEXAS L. REV. 865 (1990); Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?* 44 U.C.L.A. L. REV. 1009 (1997).

[22]*See, e.g.*, Grace Bros. Ltd. v. Uniholding Corp., No. 17,612, 2000 Del. Ch. LEXIS 101 (Del. Ch. July 12, 2000), *reprinted in* 27 DEL. J. CORP. L. 304 (2002); Goodwin v. Live Entm't, Inc., No. 15,765, 1999 Del. Ch. LEXIS 5, at *2 (Del. Ch. Jan. 22, 1999), *reprinted in* 24 DEL. J. CORP. L. 1084 (1999), *aff'd* 741 A.2d 16 (Del. 1999). *See also supra* note 15 (citing to collection of recent authority).

Language in many Delaware cases suggests that the scope of the duty of loyalty is both tightly circumscribed and clearly demarcated from that of the duty of care. For example, "[a]n allegation that properly motivated directors, [acted] for no *improper personal reason* . . . does not state a claim for breach of the duty of loyalty."[23] "[T]he essence of a duty of loyalty claim is the assertion that a corporate officer or director has misused power over corporate property or processes in order to *benefit himself* rather than advance corporate purposes."[24] Without an "attempt to show that the directors received any *personal benefit* as a result of [their conduct] . . . the alleged disclosure violations simply cannot implicate the duty of loyalty."[25] Accordingly, because care and loyalty are "distinct duties . . . without some factual basis to suspect [director] motivations, any subsequent finding of liability will, necessarily, depend on finding breaches of the duty of care, not loyalty or good faith."[26]

Much knowledgeable commentary supports the suggestion that the ambit of loyalty is both clear-cut and distinct from that of the duty of care. For example, the duty of loyalty recently was described as requiring directors to "*refrain* from self-dealing, bad faith actions, fraud and usurping corporate opportunities."[27] Similarly, "the duty of loyalty imposes an obligation on the corporate manager to *avoid* conflict of interest transactions."[28] This apparently well-marked province for loyalty leads experienced commentators to conclude that "the concepts of loyalty and due care seem analytically distinct."[29] Other experts likewise sum up the purportedly clear boundary between the coverage of the two duties as follows: "When there is *no adverse financial or personal interest*, a

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[23] *In re* GM Class H S'holders Litig., 734 A.2d 611, 618 (Del. Ch. 1999) (emphasis added) (citing Gilbert v. El Paso Co., 575 A.2d 1131, 1147-48 (Del. 1990)).

[24] Steiner v. Meyerson, [1994-1995 Transfer Binder] Fed. Sec.L. Rep. ¶98,857, at 93,146 (Del. Ch. July 19, 1995), *reprinted in* 21 DEL. J. CORP. L. 320 (1996) (emphasis added).

[25] Frank v. Arnelle, No. 15,642, 1998 Del. Ch. LEXIS 176, at *39 (Del. Ch. Sept. 16, 1998) (emphasis added) (citing Lawrence A. Hamermesh, *Calling off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1156 (1996)).

[26] *Lukens*, 757 A.2d at 731-32 (citing Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)).

[27] Brian J. McCarthy & Wallace M. Wong, *Advising the Board: Issues for Boards of Directors*, 1183 PLI/CORP. 659, 664 (2000) (emphasis added).

[28] David S. Ruder, *Duty of Loyalty—A Law Professor's Status Report*, 40 BUS. LAW. 1383, 1386 (1985) (emphasis added).

[29] R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.35, at 4-246 n.1221 (3d ed., 2002 Supp.).

question as to whether the directors have exercised good faith and requisite care implicates only the duty of care, not the duty of loyalty."[30]

On the other hand, commentary and case law also supports the opposite proposition, that the demands of the duty of loyalty are neither well-defined nor sharply differentiated from those of care. Judge Frank Easterbrook and Professor Daniel Fischel concluded: "Ultimately, though, there is no sharp line between the duty of care and the duty of loyalty."[31] Professors Lawrence Cunningham and Charles Yablon, after reviewing several Delaware decisions from the late 1980s and early 1990s, detect a judicial tendency to "blur the distinction between duty of care and duty of loyalty."[32] Evidence of judicial uncertainty is perhaps best captured in the conflicting assertions made by experienced lawyers within the same footnote of their highly-regarded treatise: "[T]he cases have blurred the distinction . . . . [C]ourts . . . [are] continuing to recognize the traditional distinctions between loyalty and due care issues."[33]

Abundant case law in Delaware—the most prominent corporate law jurisdiction—likewise shows that the contours of the duty of loyalty and the line of demarcation between that duty and the duty of care are far fuzzier than often suggested. This is made evident in frequent assertions that the mere absence of a conflicting interest by a director is insufficient either to fulfill the duty of loyalty or to differentiate loyalty from care.[34] For example, the Delaware Supreme Court concedes that director duties in a contest for corporate control setting "do not admit of easy categorization as duties of care or loyalty."[35] The difficulty of characterization partly stems from the fact that, notwithstanding case law and commentator

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[30]RODMAN WARD, JR. ET AL., FOLK ON THE DELAWARE CORPORATION LAW § 141.2, at GCL-IV-20 (4th ed., 2000 - 2 Supp.) (emphasis added) (citing Solash v. Telex Corp. [1987-1988 Transfer Binder] FED. SEC. L. RPTR. (CCH) ¶ 93, 608, at 97,727 (Del. Ch. Jan. 19, 1988)).

[31]FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 103 (1991). *See* Branson, *supra* note 11, at 383-84. Professor Alison Anderson noted in 1978 that both the careless and the disloyal director are, in one sense, choosing self-interest over duty to others, the former choosing the "easy life" and the latter choosing "tangible benefits." Alison Anderson, *Conflicts of Interest: Efficiency, Fairness And Corporate Structure*, 25 U.C.L.A. L. REV. 738, 758 n.59 (1978). Although the duties are similar in the sense noted, a thesis of this article is that loyalty and care each have a more affirmative thrust that does not involve self-gain.

[32]Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor: *A Unified Standard (and the End of* Revlon *Duties?)*, 49 BUS. LAW. 1594, 1625 (1994).

[33]BALOTTI & FINKELSTEIN, *supra* note 29, at 4-246 to 4-247 n.1221.

[34]*In re* Santa Fe Pacific Corp. S'holders Litig., 669 A.2d 59, 67 (Del. 1995). *See also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (citing Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

[35]*See In re* Santa Fe Pac. Corp. S'holders Litig., 669 A.2d at 67.

pronouncements to the contrary,[36] fulfilling the duty of corporate loyalty demands more than the absence of director self-interest.[37] Rather, "evidence of disloyalty . . . include[s], but certainly [is] not limited to, the motives of entrenchment, fraud upon the corporation or the board, abdication of directorial duty, or the sale of one's vote."[38] This inclusive, illustrative phrasing suggests that the duty of loyalty is open-textured rather than tightly-bounded and that merely avoiding instances of personal interest will not discharge the duty. The Delaware Court of Chancery reinforces this point with its observation that a breach of loyalty can be unintended, and can occur even when board action is taken in good faith.[39] Chancellor Chandler, after noting that his view might be "wrapped in lofty idealism,"[40] recently generalized that the "fiduciary duty of loyalty . . . is always implicated where the board seeks to thwart the action of the company's shareholders."[41] Vice Chancellor Strine has likewise observed that self-interest is not always present in a loyalty breach, stating: "[A] fiduciary may act disloyally for a variety of reasons other than personal pecuniary interest; and . . . regardless of his motive, a director who consciously disregards his duties to the corporation and its stockholders may suffer a personal judgment for monetary damages for any harm he causes."[42]

Decisions in the oversight and disclosure contexts also show that the sphere of loyalty is not easily cordoned off from the duty of care on the faulty ground that self-interest is always necessary to trigger loyalty. This can readily be seen in the director oversight and disclosure contexts. The Delaware Supreme Court has characterized the conduct of *disinterested* directors who abandon their oversight responsibilities as a breach of the duties of care *and* loyalty.[43] Recently, a federal appeals court applying Delaware law held that allegations of a reckless breach of the duty of care in exercising oversight would be construed as a breach of good faith, and

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[36]*See supra* notes 23-30 and accompanying text.

[37]*See supra* notes 23-30 and accompanying text.

[38]Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 363 (Del. 1993) (citations omitted).

[39]Blasius Indus. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988); *accord* State of Wisconsin Inv. Bd. v. Peerless Sys. Corp., No. 17,637, 2000 Del. Ch. LEXIS 170, at *27 (Del. Ch. Dec. 4, 2002, *reprinted in* 27 DEL. J. CORP. L. 726, 739 (2002), *reargument denied*, No. 17,637, 2001 Del. Ch. LEXIS 1 (Del. Ch. Jan. 5, 2001).

[40]*State of Wis. Inv. Bd.*, 2000 Del. Ch. LEXIS 170, at *44.

[41]*Id.*

[42]Nagy v. Bistricer, 770 A.2d 43, 49 n.2 (Del. Ch. 2000).

[43]*See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 363 (Del. 1993) (citing Lutz v. Boas, 171 A.2d 381 (Del. Ch. 1961) (referencing a director abdication case, as an example of disloyalty)). *See also* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1284 n.32 (Del. 1988) (observing that a board's abandonment of oversight functions breaches duties of loyalty and care).

not within the statutory exculpation.[44] Another federal appeals court interpreted a complaint alleging intentional breach of director oversight duties as a breach of good faith falling outside the exculpation provision.[45] In the disclosure context, the court repeatedly has stated that the "duty of directors to observe proper disclosure requirements derives from the combination of the fiduciary duties of care, loyalty and good faith."[46] Bottoming director oversight and disclosure responsibilities on loyalty,[47] as well as care,[48] can only mean there is more to the duty of loyalty than an obligation to "refrain from"[49] or "avoid"[50] self-interest.

Possibly, these varied statements bring to light that courts and commentators do not really know what "loyalty" means, or perhaps they simply reveal disagreement as to what that particular duty demands. Either possibility would account for the frequent, seemingly inconsistent descriptions of loyalty's requirements. Alternatively, "loyalty" might be a more complex notion than commonly thought and therefore may have different meanings. In that event, courts and commentators may vacillate in their use of the concept, not really explaining the various meanings they are invoking or even being fully aware of them. If this is the case, what appear to be *incompatible* statements about loyalty are simply *incomplete* statements. Courts and commentators tend to focus on a singular aspect of loyalty raised in the *particular* context at hand and then speak *categorically* about it. The practice of generalizing from the particular may result in *rhetorical* carelessness about loyalty. The fact remains, however, that a variety of director *conduct* is judicially recognized as raising loyalty concerns. This indicates an appreciation that the concept of loyalty may be comprised of different dimensions. What are the possible meanings of "loyalty?"

B. *The Disparate Meanings of Loyalty*

In his insightful essay on loyalty, Professor George Fletcher differentiates between what he calls the "minimal condition" and the

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[44]McCall v. Scott, 250 F.3d 997, 1000-01 (6th Cir. 2001).

[45]*In re* Abbott Labs. Deriv. Litig., 325 F.3d 795, 809, 811 (7th Cir. 2003).

[46]Malone v. Brincat, 722 A.2d 5, 11 (Del. 1998) (citing Cinerama Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995)). The author does not necessarily agree with the suggestion in these cases that there are three fiduciary duties, rather than two (loyalty and care), but instead cites the cases for recognizing that care and loyalty can work in tandem.

[47]*See, e.g.*, Emerald Partners v. Berlin, 726 A.2d 1215 (Del. 1999).

[48]*See, e.g.*, Zirn v. VLI Corp., 681 A.2d 1050 (Del. 1996).

[49]*See supra* text accompanying note 26.

[50]*See supra* text accompanying note 27.

"maximum condition" for loyalty.[51] The "minimum condition" requires the loyal actor to "reject temptation"[52] and consists of "not betraying the object of one's loyalty."[53] Examples of minimal loyalty include "not committing adultery, not fighting for the enemy, [and] not worshiping foreign gods."[54] This view of loyalty, as demanding "the minimum commitment of nonbetrayal,"[55] parallels philosopher John Ladd's view that "*at the very least*, loyalty requires the complete subordination of one's own private interest."[56] Moreover, it comports with sociologist James Hunter's recent argument that the "most basic element of character is *moral discipline*,"[57] the "most essential feature [of which] is the inner capacity for *restraint*—an ability to *inhibit* oneself in one's passions, desires, and habits within the boundaries of a moral order."[58]

By way of contrast, Fletcher describes the "maximum condition" of loyalty as involving "an element of devotion"[59] and "affirmative duties of devotion"[60] as well. In this more positive aspect of loyalty, he adopts the view of Josiah Royce that loyalty is "*[t]he willing and practical and thoroughgoing devotion of a person to a cause*."[61] In this most robust account of loyalty, it is not simply a restraint or inhibition on *self*-interest.[62] Instead, it runs in favor of *another*, such as a "spouse, nation, and a jealous God."[63] Moreover, this dimension of loyalty is never general or abstract, but rather is "always specific; a man is loyal to *his* lord, *his* father, or *his* comrades."[64]

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[51]GEORGE P. FLETCHER, LOYALTY—AN ESSAY ON THE MORALITY OF RELATIONSHIPS 9 (1993).

[52]*Id.*

[53]*Id.* at 40.

[54]*Id.*

[55]FLETCHER, *supra* note 51, at 24.

[56]LADD, *supra* note 1, at 98 (emphasis added).

[57]JAMES DAVISON HUNTER, THE DEATH OF CHARACTER 16 (2000).

[58]*Id.* (emphasis added).

[59]FLETCHER, *supra* note 51, at 9, 24.

[60]*Id.* at 24.

[61]JOSIAH ROYCE, THE PHILOSOPHY OF LOYALTY 16-17 (1924).

[62]FLETCHER, *supra* note 51, at 40.

[63]*Id.*

[64]LADD, *supra* note 1, at 97. WOLFE, *supra* note 3, at 26 (providing that "[l]oyalty, after all, is not an abstract virtue . . . . The absence of loyalty is not some theoretical state of affairs that may cause problems in the future, but an everyday affront").

This more affirmative cast of loyalty dovetails with what James Hunter describes as a second element of character, "moral attachment,"[65] a necessary ingredient if character "is defined not just negatively but positively as well."[66] This facet of character "reflects the *affirmation* of our commitments *to* a larger community."[67] Hunter, like Fletcher, underscores the affirmative dimension of "attachment."[68] At the same time, like Ladd, he stresses the particularity of "attachment," stressing that its exercise is not abstract or general, but rather is always historically, socially, and culturally situated.[69]

This enriched framework for understanding the twofold nature of loyalty, drawn from moral philosophy, helps elucidate the seemingly inconsistent judicial and commentator assertions about the duty of loyalty found in corporate law discourse. Those courts and commentators emphasizing the necessity of personal gain or benefit as the hallmark of a loyalty *breach*,[70] or the corresponding need to "refrain from"[71] or "avoid"[72] self-interest to *fulfill* the duty, are describing the "minimal condition for loyalty."[73] Courts and scholars using loyalty in this tightly-bounded sense of nonbetrayal can quite readily differentiate this type of loyalty claim from a duty of care claim. A recent example is Professor Melvin Eisenberg's statement that "[t]he duty of loyalty concerns the standards that apply to the conduct of corporate actors who are *not free of self-interest*."[74] Put another way, "[t]he duty of loyalty is a shorthand expression for the duty of fair dealing by . . . [directors] when they are *financially interested* in a matter."[75] This formulation accurately expresses the minimal demand of loyalty. It is wrong, however, if it is meant to suggest that loyalty is not always demanded, but is required only of those under a specific

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[65]HUNTER, *supra* note 57, at 16. Albert Hirschman also describes loyalty as "attachment" to an organization, and notes that it may precede or follow actual influence within an organization. *See* ALBERT HIRSCHMAN, EXIT, VOICE, AND LOYALTY—RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 77 (1970).

[66]HUNTER, *supra* note 57, at 16.

[67]*Id.* (emphasis added).

[68]*Id.*

[69]*Id.* at 11.

[70]*See supra* notes 23-26 and accompanying text.

[71]*See supra* text accompanying note 27.

[72]*See supra* text accompanying note 28.

[73]FLETCHER, *supra* note 51, at 9.

[74]Eisenberg, *supra* note 7, at 1265 (emphasis added).

[75]*Id.* at 1271 (emphasis added).

temptation.[76] More importantly, it neglects the way in which a person, without personal gain, can fail to be loyal by not affirmatively being devoted to the well-being of another.

Conversely, cases and commentary unwilling to narrowly confine loyalty, or to regard it as always sharply distinguished from care, may do so out of an (unspoken) appreciation of loyalty's more affirmative, maximal thrust of "devotion"[77] or "attachment."[78] In fact, the twofold "minimal" and "maximum" dimensions of loyalty, and their corresponding demands of nonbetrayal and devotion, permeate corporate law rhetoric. Some examples from corporate law discourse will help in seeing this.

The seminal case of *Guth v. Loft, Inc.*[79] succinctly captures the dual mandate of loyalty. The Delaware Supreme Court, addressing loyalty in the usurpation of the corporate opportunity context, described the double thrust of director duty as "not only *affirmatively to protect* the interests of the corporation committed to his charge, but also to *refrain from* doing anything that would work injury to the corporation, or to *deprive it* of profit or advantage which his skill and ability might properly bring to it."[80] Highlighting the minimal facet of loyalty in that case, where a director had seized a corporate opportunity for personal advantage, the court placed the linguistic emphasis on the nonbetrayal aspect.[81] The Delaware Supreme Court did so only after first recognizing the duty to affirmatively protect corporate interests, the aspect less pointedly at issue.[82] Occasionally, the emphasis will run the other way, as where the Delaware Supreme Court reversed the phrasing in *Guth* to underscore a director's duty of "maximum" loyalty.[83] That court reasoned: "Not only do these principles demand that corporate fiduciaries absolutely *refrain from* any act which breaches the trust reposed in them, but also to *affirmatively protect* and defend those

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[76]The Delaware Supreme Court has described director duty as not operating "intermittently, but is the constant compass by which all director actions for the corporation . . . must be guided." Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998).

[77]*See supra* notes 59-61 and accompanying text.

[78]*See supra* note 65 and accompanying text.

[79]5 A.2d 503 (Del. 1939). *See* WARD ET AL., *supra* note 30, § 141.2.1.1, at GCL-IV-18.

[80]*Guth*, 5 A.2d at 510 (emphasis added). For a very similar, double-edged description of director duty, see Cumberland Coal & Iron Co. v. Parish, 42 Md. 598, 606 (1875).

[81]*See Guth*, 5 A.2d at 510.

[82]*Id.*

[83]*See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1289 (Del. 1988).

interests entrusted to them."[84] That court stressed that subduing self-serving impulses is not, by itself, the same as acting loyally.[85]

Once alert to the twofold dimension of loyalty, one begins to discern its acknowledgment with some frequency in corporate law. For example, the Model Business Corporation Act bends over backward to facilitate and uphold director conflict of interest transactions.[86] Nevertheless, in a note on Fair Transactions—where the legal standard of "fairness" for such conflict transactions is elaborated — the reviewing court is admonished that to sustain the transaction it must find "favorable results . . . from the perspective of *furthering* the corporation's business activities."[87] In other words, where self-interest is or could be present, merely examining the substantive and procedural fairness of a self-interested transaction is insufficient. To fulfill the director's duty of loyalty, the corporation's interest must be more than unharmed or unbetrayed; it must affirmatively be furthered.

The American Law Institute's *Principles of Corporate Governance* reaches the same result, stating that to sustain a director conflict of interest transaction, a determination must be made that the "transaction *affirmatively* will be in the corporation's best interest."[88] The *Corporate Director's Guide Book* similarly highlights the affirmative character of loyalty whereby "[t]he duty of loyalty requires directors to exercise their powers in the interests of the corporation and not in the directors' own interest or in the interest of another person (including a family member) or organization."[89] The Guide Book's formulation denies the legal sufficiency of the "minimal condition" of loyalty in two ways. First, it emphasizes the need to affirmatively advance the corporation's interests. Second, it points out that promoting a third-party's interests ahead of the corporation's is as disloyal as a director furthering her own interests, a point too frequently forgotten in corporate law.[90]

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[84] *Id.* at 1289 (emphasis added); *accord* McMullin v. Beran, 765 A.2d 910, 919 (Del. 2000) (reasoning that directors have an "affirmative duty to protect the interests of the minority, as well as the majority, stockholders").

[85] *See Mills Acquisition*, 559 A.2d at 1280.

[86] MODEL BUS. CORP. ANN. § 8.61 (3d ed. 1998/99 Supp.)

[87] *Id.* (emphasis added). *See, e.g.*, Fill Bldgs. Inc. v. Alexander Hamilton Life Ins. Co., 241 N.W.2d 466, 469 & n.7 (Mich. 1976).

[88] AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 219 (1992) (emphasis added).

[89] COMMITTEE ON CORPORATE LAWS, AMERICAN BAR ASS'N, CORPORATE DIRECTOR'S GUIDEBOOK (1994), *reprinted in* 49 BUS. LAW. 1243, 1254-55 (1994).

[90] *See* RESTATEMENT TRUSTS (SECOND) § 170, comment q (stating that it is improper for a trustee to act to benefit a third party rather than the trust estate). For recent examples of cases recognizing that directors can be disloyal by preferring interests other than their own over the

These instances, like those cited earlier,[91] reveal the true scope of loyalty in corporate law discourse. Recurrent corporate law rhetoric, reflecting the "devotion" facet of loyalty, refutes the position that a director fulfills the duty of loyalty merely by refraining from disloyal (betrayal) behavior. As Professor Gregory Alexander recently stated: "[F]iduciary law's loyalty obligation requires that one party completely subordinate self-interest *and* act exclusively for the benefit of the other party."[92]

Upon seeing that loyalty both in and out of corporate law means more than the absence of disloyalty (betrayal), the question arises as to how an enriched understanding of loyalty's two meanings might help judges differentiate loyalty from care for the purpose of interpreting section 102(b)(7) and similar corporate statutes in other states. Put another way, how is the affirmative "devotion" or "attachment" dimension of loyalty related to the norm (and duty) of "care?" Philosophically, the issue is whether identifying the two facets of loyalty serves to create clarity between care and loyalty, or whether it reveals that there is some intersecting of the two moral/legal virtues. This obviously depends not only on what "loyalty" means, but also on what "care" means. Perhaps it too has more than one dimension, either as a social norm, as a legal duty or both. Possibly, the positive reach of loyalty partially overlaps care, or perhaps loyalty is one component of the even richer-dimensioned and more fundamental concept of "care." Stated differently, the more full-bodied the concept of loyalty is, the more likely that the philosophical boundary between loyalty and care is "fuzzy" rather than sharp. Corporate law's binary liability scheme, however, as manifested in section 102(b)(7) and similar statutes in other states, contemplates no such ill-defined dividing line between the two duties. Supposedly, Delaware law is clear in that directors face no personal liability for breach of "care" claims, only for breach of "loyalty" claims.[93] This tidy appraisal assumes a discreteness of meaning more hoped for than real. It hinges entirely on regarding care as one-dimensional and on distinguishing care from only one facet of loyalty—the "minimum" condition of nonbetrayal.

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corporation's well-being, see *infra* text accompanying notes 161-82.

[91] *See supra* text accompanying notes 34-50.

[92] Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767, 776 (2000) (emphasis added).

[93] *See supra* notes 11-13 and accompanying text.

C. *The Meeting of Loyalty and Care*

William Bennett explicitly links loyalty and care when he states that "[t]o be . . . loyal . . . means to operate within a certain framework of caring seriously about the well-being of [another]."[94] Caring about someone in this view is a necessary element of loyalty. It does not logically follow that the converse is true; that is, that loyalty necessarily and always is an element of care. Nor does it follow from such linkage that care and loyalty mean the same thing. Finally, notwithstanding Bennett's use of the word "means," the statement is not definitional in the same way Fletcher's notion of "maximum" loyalty helps define loyalty. Rather, the statement essentially is a claim that humans are loyal only *because*, whatever the individual's normative framework, they first care seriously about the well-being of another. In short, "care" underlies "loyalty" so that without care there is no loyalty.

The view that care undergirds loyalty is not, from a philosophical standpoint, a startling conclusion. Care, in life and thought, is a rich and foundational concept, sufficiently so that Martin Heidegger viewed care as such "a primordial structural totality" that "[b]eing must be defined as 'care.'"[95] Religious stories confirm the central place of care. This is seen in the story of the Good Samaritan, who himself "took care" of a beaten man and later instructed an innkeeper to "take care of him,"[96] and in Christ's famous charge to His apostle Peter to "[t]ake care of my sheep."[97] Moreover, care is a multidimensional rather than a simple, unidimensional idea. For example, section 141(a) of the Delaware General Corporation Law places the business and affairs of a corporation under the "direction of a board of directors."[98] "Direction" is defined as the guidance and supervision of another's welfare or care.[99] This is similar to the phrase "under a doctor's care." A doctor must "take care of" his or her patient just as the board of directors is charged to "take care of" the corporation's business and affairs. Physician or directorial neglect or abdication of duties

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[94]WILLIAM J. BENNETT, THE BOOK OF VIRTUES 665 (1993). Albert Hirschman also connects loyalty and care, describing a "loyalist" as one "who cares" about an organization. ALBERT HIRSCHMAN, EXIT, VOICE, AND LOYALTY—RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 83 (1970). *See id.* at 99-100, 104.

[95]MARTIN HEIDEGGER, BEING AND TIME 238 (John Macquarrie & Edward Robinson trans., Harper & Row 1962) (1927).

[96]*Luke* 10:34-35, THE HOLY BIBLE (New American Standard Bible).

[97]*John* 21:16-17, THE HOLY BIBLE (New International Version Bible).

[98]DEL. CODE ANN. tit. 8, § 141(a) (1991 & Supp. 2000).

[99]*See In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (noting director "supervisory" role under § 141(a)).

is a violation of care and a failure to "take care of" in this most fundamental sense.

Besides using the term "care" to mean taking "care of" someone, we also use "care" to mean that someone "cares for" the well-being or interests of another. When someone "cares for" another, the affirmative object of attention and energy is the well-being of the other, not the actor's interests or those of a third party.[100] Neglect violates this obligation of care because it is a failure to "care for" the other's welfare. Promoting personal self-interest (betrayal) rather than the other's advancement also is a failure to "care for" the proper interests. Accordingly, the notion of care as affirmative concern and solicitude *for* the interests of another, care is the foundation of, and the key linkage to, the notion of loyalty. A moral actor, such as a director, cannot be said to be loyal if he or she fails to discharge the obligation to "care for" the corporation, *either* by serving his or her own or another's interests to the detriment of the corporation (betrayal) *or* by failing to affirmatively advance the corporation's interests.[101] This particular meaning of care, to affirmatively and unremittingly[102] "care for" the interests of another, *means* loyalty in Professor Fletcher's and Josiah Royce's sense of "devotion" and in James Hunter's sense of "attachment." Moreover, an underlying stance of "care for" the welfare of another supplies an explanation for *why* loyal conduct occurs—loyalty is a behavioral extension of a deeper disposition.[103]

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[100]Recently, the author received a mailing from his alma mater, Carleton College, the cover of which read "care for Carleton." Inside was a story about a freshman student who directly benefits from alumni giving and a request to "care for" the work of the college by making a donation. In the author's view, such a request, while of course institutionally self-serving, nonetheless attractively appeals to the alumni's personal, humane concern for advancing the good work of the school.

[101]*Cumberland Coal & Iron. Co.*, 42 Md. 598 (1875), captures this point. Observing that a "corporation is entitled to the supervision of all the directors," the court noted that if a director deals with his own company "the corporation is deprived of the benefit of his judgment and supervision in regard to matters in which such judgment and supervision might be most essential to its interest and protection." *Id.* at 606. In other words, even assuming the director self-dealing is done in a procedurally proper manner, mere *avoidance* of *disloyal* conduct does not mean a director has discharged his (*loyalty*) duty to *promote* corporate interests. This may account for the requirement, in self-dealing settings, that the transaction affirmatively further the corporation's interests. *See supra* notes 84-88 and accompanying text. For brief treatment of the loyalty/care connection in the professional responsibility setting, see Dennis J. Tuchler, *Unavoidable Conflicts of Interest and the Duty of Loyalty*, 44 ST. L. UNIV. L.J. 1025, 1030-32 (2000).

[102]The Delaware Supreme Court has described director duties as "unremitting" and "constant." Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998).

[103]A recent expression of this appears in Vice Chancellor Jacobs' opinion in *Emerald Partners v. Berlin*, No. Civ. A. 9700, 2001 Del. Ch. LEXIS 20, at *89 (Del. Ch. Feb. 7, 2001), *rev'd* 787 A.2d 85 (Del. 2001), where, in finding that non-interested directors had acted loyally, he stated that the directors in that case had acted out of a "conscious *concern for* . . . the minority

Professor Maureen Cavanaugh's recent work on Aristotle's understanding of homonyms elucidates a useful framework for understanding this interconnection between care and loyalty.[104] Care is an example of a "multivocal" word,[105] a word with more than a single meaning. Consider the following three sentences:

(1) A board of directors is to "take care of" the corporation's business and affairs;

(2) A board of directors is to "care for" the corporation and its stockholders; and

(3) A board of directors is to act "with care."

The three phrases using the word "care" do not mean the same thing in all three sentences. Therefore, the phrases employing the same word "care" are not synonymous. For example, one can "care for" (as being concerned about) the interests of another without necessarily acting "with care." Likewise, one can act "with care" without acting out of "care for" the interests of another. For example, the actor might "competently" advance the wrong interests. Although not synonymous, the word groups revolve around a "core,"[106] meaning that all three phrases using the word "care" do "coalesce around a core notion,"[107] even though a different signification is voiced in each phrase. Specifically, the phrase "care for" denotes what we mean by the term "loyalty." The phrasing "care for" is a "derived"[108] or "associated"[109] instance of the core notion of "care." Simply by virtue of sharing at its center the word "care," however, does not make the phrase "care for" synonymous with "take care of," i.e., indicating supervisory responsibility, or with the phrase that directors are to act "with care," i.e., indicating a manner of acting.

For corporate law, the implications of the philosophical and linguistic linkage between care and loyalty are profound. Recall that modern corporate law now seeks to classify director wrongdoing into either the duty of "care" or the duty of "loyalty" category because only a breach of the latter supports money damages.[110] Yet, if the concept of loyalty is

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stockholders' welfare." *Id.* (emphasis added). *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that director actions should be "motivated by a good faith *concern for* the welfare of the corporation and its stockholders") (emphasis added).

[104]Maureen B. Cavanaugh, *Order in Multiplicity: Aristotle on Text, Context, and the Rule of Law*, 79 N.C. L. REV. 577 (2001).

[105]*Id.* at 624 & n.174.

[106]*Id.* at 638.

[107]*Id.* at 638 & n.220.

[108]Cavanaugh, *supra* note 104, at 643-44.

[109]*Id.* at 645-46.

[110]*Supra* notes 15-16 and accompanying text.

deeply rooted in and intertwined with care in the ways developed above, there is no easy division between all loyalty and all care claims. Therefore, it is an oversimplification to say there is no personal liability for director "care" breaches.[111] To the extent the affirmative dimension of loyalty means to "care for," failing to care for the interests of the corporation and its shareholders signifies a breach of loyalty supporting an award of damages.[112] A sense of the deep connection articulated here may actually lie implicit in those cases grounding certain director obligations in both care and loyalty, e.g., oversight and disclosure.[113]

Indeed, if the modern director duty of care is essentially the modest duty to act "with care," in the phrasing above,[114] by default that leaves the duty of loyalty as a potentially fertile, and largely unmined, residual notion capacious enough to encompass all other affirmative obligations thought to be owed by a director charged to "take care of" and "care for" the corporation. Such a rendering of loyalty is a considerably more demanding directorial duty than mere nonbetrayal.[115] Moreover, such a reading finds

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[111]*See, e.g.*, Rosser v. New Valley Corp., No. 17,272, 2000 Del. Ch. LEXIS 115, at *26 (Del. Ch. Aug. 15, 2000); Oliver v. Boston Univ., No. 16,570, 2000 Del. Ch. LEXIS 104, at *20 (Del. Ch. July 18, 2000) (revised July 25, 2000). Section 102(b)(7) does not expressly state that corporations can absolve directors of liability for "care" breaches, understanding "care" as both a multi-dimensional norm and a legal duty. Rather, it generally absolves for "breach of fiduciary duty," subject to four exceptions, one of which is the duty of loyalty. *See supra* note 12. Thus, any aspect of fiduciary duty characterized as "loyalty" in nature, even if at some root level it implicates one or more facets of the ideal or norm of "care," would support a damage award because the statute did not pointedly nullify damages for "care" claims. Thus, only those breaches of the narrower legal *duty* of care—i.e., the process-oriented duty to act "with care"—that do not implicate loyalty are immune from a damage award.

[112]Chancellor Allen addressed director monitoring responsibility in the context of a duty of care claim charging that defendants had failed to exercise adequate monitoring. In his discussion, however, he also takes up director liability for outright neglect of, or inattention to, monitoring. *See In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del. Ch. 1996). He states that "only a sustained or systematic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability." *Id.* A "sustained or systematic failure" of oversight is a failure to "take care of" or properly "care for" the interests of the corporation and its stockholders. In this respect, it is a breach of the affirmative dimension of loyalty. *See supra* text accompanying note 42. Although not describing it in that way, Chancellor Allen does describe such conduct as possibly showing a lack of good faith—one of the exceptions to exculpation in § 102(b)(7). Therefore, it could be the sort of conduct supporting damages. Moreover, many Delaware decisions regard bad faith as an instance of disloyalty, see *infra* notes 157 and 245, thus bolstering the view that a "sustained or systematic" failure of oversight might be a loyalty breach supporting damages as well as a breach of one dimension of the care norm.

[113]*See supra* text accompanying notes 34-50.

[114]*See* Johnson, *supra* note 5, at 810, 824-32.

[115]Again, as noted earlier, *supra* note 17, some might prefer "good faith" as a doctrinal vehicle for attaining what this article seeks to attain through "loyalty."

ample support in corporate law's own bi-vocal mode of discourse.[116] It is, ironically, the very thinness of the term "care" in modern corporate law that leaves the richer, more demanding dimensions of that core *norm* fully available for importing into corporate law via the *doctrine* of loyalty.

III. THE PERILS AND VALUE OF MORAL LANGUAGE IN CORPORATE LAW

Appreciating the breadth of "loyalty" and "care," and the central place of those concepts in our social-moral lives, is one thing. Believing, however, that such a moral vocabulary is necessarily appropriate or useful for judges and lawyers working in corporate law is more controversial. For example, one might believe that judges deciding the outcomes of cases and lawyers advising boards of directors are either unwilling or unable to approach the duty of loyalty in the way suggested. These and other practical concerns with the analysis are valid, and will be addressed in the final section of the article. This section, however, provides a more theoretical critique and defense of moral language in corporate law discourse.

Leading critics of moral rhetoric in the corporate law narrative include Judge Frank Easterbrook and Professor Daniel Fischel, who assert that "[f]iduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings."[117] Easterbrook and Fischel believe moral language in corporate law is, as Gregory Alexander characterizes it, "overblown rhetoric that obscures more than it illuminates."[118] Easterbrook and Fischel would either expunge such moral rhetoric altogether or strip it of any vital meaning.[119]

Professor Alexander's recent response to Easterbrook and Fischel rightly emphasizes the connection between how judges rhetorically frame fiduciary issues and how they reach outcomes when he stated: "Rhetoric matters, too, precisely because it affects behavior."[120] One key underpinning of moral language in fiduciary cases is judicial sensitivity to

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[116]*See supra* text accompanying notes 80-92.

[117]Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993). Professors Jonathan Macey and Geoffrey Miller agree with this view. Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1068 (1990) ("[C]ourts should treat an allegation of a breach of fiduciary duty as they would treat any alleged breach of contract.").

[118]Alexander, *supra* note 92, at 767.

[119]Easterbrook & Fischel, *supra* note 117, at 427.

[120]Alexander, *supra* note 92, at 777.

the imbalance of power between fiduciary and beneficiary.[121] This imbalance largely stems from the beneficiary's passivity and the fiduciary's control. Shareholder passivity results from, among other factors, structural efficiency considerations, including the difficulty and costliness of detecting and sanctioning abuses of power, and a learned reliance on the effective safeguarding of fiduciary constraints. The result is a contextual vulnerability quite different than that of arm's length bargain relationships.[122] Fiduciary strictures induce resource providers to assume socially desirable, but vulnerable, positions only by a proven track record of having dependably watched over the interests of those who make themselves susceptible.

Agreeing that courts use the overtly normative language of "loyalty" and "care" to describe director duties, and that there are good policy reasons for doing so, this article has examined a different question. Namely, whether in a post- Enron world the moral vocabulary inherited by corporate law will be *fully* used, or instead will be given a narrow and uncommon reading. This article explores the prospects for that two-word vocabulary through the sight-sharpening lenses of cultural-religious stories and language analysis. The aim is to highlight the surprising range and suppleness of corporate law's core notions of loyalty and care. As with fine china used for everyday dinnerware, however, the very paucity of corporate law terms may mean that exquisite but overworked words like "care" and "loyalty" risk being reduced to hackneyed, professional cant. Pulled out of the linguistic cupboard reflexively, these choice word-vessels may be taken for granted. Thus, only rarely are their subtle shadings really looked at.

Whether the full possibilities of "care" and "loyalty" can be put to service in contemporary corporate law discourse about director duties depends, at the theoretical level, on two matters. First, corporate law must decide whether the director, to whom the duties of loyalty and care legally attach, is to be regarded as a full-fledged, human, moral actor. Enduring stories of human loyalty—for example, that of the humbled Roman statesman and general Cincinnatus,[123] or Joseph in the book of Genesis[124]—uplift us because the actors do more than eschew self-interest. These figures freely choose to advance the interests of others.[125]

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[121]Tamar Frankel, *Fiduciary Law*, 71 CAL L. REV. 795, 832 (1983); Deborah Demott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 902-05.

[122]Alexander, *supra* note 92, at 777.

[123]*The Story of Cincinnatus*, as retold by James Baldwin, in BENNETT, *supra* note 94, at 671-74.

[124]*Genesis* 39, THE HOLY BIBLE (New International Version).

[125]*Id.* at 39:12.

Cincinnatus left home and work to lead Rome for sixteen crucial days before relinquishing power, while Joseph not only refused to sleep with the boss' wife,[126] his faithful efforts served to prosper his master both in house and field.[127]

The language of loyalty is fitting for such persons. Although flawed, strenuously challenged, and subjected to severe temptation, they freely choose allegiance to another. For instance, in Verdi's renowned opera, *Il Trovatore*,[128] Leonora offers herself to Count di Luna in exchange for the Count sparing the life of his rival, her beloved Manrico. Manrico initially curses Leonora for "selling" her love, but when the poison she secretly swallows takes hold and Manrico sees the distress caused by his response to Leonora's sacrificial act, he understands the extent of her deep devotion to him.[129] Moral language suits Leonora's actions. She is loyal in more than the nonbetrayal sense; that is, she is fully loyal in her commitment to Manrico's well-being.[130]

Conversely, moral language is ill-fitting and risks debasement if used to describe persons who are not genuinely regarded as full-blown moral actors at all, but who are instrumentally conceived of as economic functionaries. This principle fully applies to corporate directors. If they are perceived in purely economic terms, then moral language should be discarded or at least rendered innocuous. In its place, we could substitute, as more suitable and honest, the compressed discourse of finance and economics, with talk of "bargain," "efficiency," and "agency costs." Moreover, perhaps the rhetoric of game theory and its arid description of changed behavior as "tipping" will be adopted.[131] It is not that these economic notions are not important ideas. Rather, the issue is whether one or another *mode* of discourse will predominate to the detriment and exclusion of moral discourse.

Importantly, it bears further remembering that the received terms of professional discourse reflect not just a depiction of how we think an area of human endeavor actually *does* work, but also how it *could* work. As

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[126] *Id.*

[127] *Id.* at 39:5. Other stirring examples of loyalty found in the Old Testament include Jonathan's devotion to his friend and future-King David, even in the face of Jonathan's father's (King Saul's) hatred of David, and Naomi's attachment to her mother-in-law, Ruth, in preference to her own interests. *I Samuel* 20 & *Ruth* 1, THE HOLY BIBLE (New International Version). In the religious setting, of course, these stories transcend personal loyalty and point to (and illustrate) the devotion of God to His People.

[128] Giuseppe Verdi, *Il Trovatore* (1857).

[129] *Id.*

[130] *Id.*

[131] Eisenberg, *supra* note 7, at 1264.

James Hunter stated: "Language itself provides horizons for our moral imaginations."[132] We should be careful about too quickly discarding or unduly confining an established vocabulary, as the Girl Scouts have already done and as Easterbrook and Fischel suggest for corporate law, on the ground that it falsely depicts what *is* observed. To be sure, descriptive inaccuracy is always possible and should be guarded against. The function of moral discourse, however, unlike scientific discourse, is to help us transcend actual practice, to imagine it with fresh eyes, and to contemplate and inspire movement toward reform. This distinction will be central to our eventual willingness to assess Enron as a moral failure and not simply an accounting blunder or a regulatory foul-up. We need at our disposal moral categories and moral discourse before we can make such an assessment.

A second matter needs attention as part of settling on the terms of corporate law discourse. This concerns how we conceptualize corporate relationships. Free market contractarians who regard the corporation solely as a "nexus of contracts" utterly ignore the "nexus of affection and sympathy,"[133] which binds social actors together and "leads people to share one another's sorrows and joys."[134] In doing so, they disaggregate the corporation as a social institution into bargain-making economic actors, who act not out of self-sacrificing sympathy and devotion, but solely to maximize individual welfare. This is a theoretical view rooted in social atomism. Loyalty, in this theory of corporate relationships is at best a utilitarian, if quaint notion aimed at proscribing "agents" (directors) from betraying their "principals" (shareholders). At worst, loyalty (understood as devotion to another) is a pathetic illusion. Yet, loyal conduct frequently is not veiled self-interest.[135] Is that how the heroic actions of rescue workers on September 11 are best explained? Few in society at large or in academia would choose "self interest" to describe what are acts of self-sacrifice. Moreover, as Hirschman famously notes, the norm of loyalty is not irrational, but is "socially useful" in inhibiting influential persons from exiting rather than "staying behind" to improve an organization, thereby

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[132]HUNTER, *supra* note 57, at 24; *see supra* text accompanying note 121.

[133]ROGER SCRUTON, AN INTELLIGENT PERSON'S GUIDE TO PHILOSOPHY 113 (1998).

[134]*Id.*

[135]*See* Johnson, *supra* note 21, at 895 n.113 (quoting Richard Epstein, *The Independence of Judges: The Uses and Limitations of Public Choice Theory* 39 (Sept. 13, 1989) (paper delivered at Washington and Lee University School of Law) (on file with author) ("[T]heory must deal with the most powerful counterexamples of persons who do appear to behave with disinterested benevolence to their fellow man . . . . Such is in accord with our considered intuitions about self-interests, as with David Hume's wonderful phrase, 'self-interest with confin'd generosity.'").

possibly halting further decline.[136] Society gains when a rescue worker "stays behind" rather than flees. Likewise, the same result occurs, though less dramatically, when directors, officers, and employees do so in corporate life.

There is, in the contract model, no moral quality to the director conduct sought, only the fulfillment (or breach) of already bargained-for behavior that in turn rationally advances self-interest.[137] Spontaneous, devoted behavior exceeding what was agreed to defies explanation in the contractarian account. The exception is forward-looking behavior instrumentally calculated to signal trustworthiness, which thereby induces others to transact future business with the actor—to the actor's advantage. This position dismisses the moral dimension of "economic" actors by asserting that action supposedly taken out of normative commitment actually is rooted in self-interest. It is simply the case, the argument goes, that as yet we have "no psychological account"[138] to explain how or why such self-interested action gets converted into moral-sounding (and self-deceiving) claims that action is normatively grounded.[139] Moreover, because this theoretical position successfully disassembles the corporate institution, both sociologically and philosophically, there remains no "superpersonal entity to serve as [loyalty's] object."[140] After all, loyalty as devotion requires the existence of another to whom one can be committed.[141] As such, in the austere contractarian account, there is no meaningful notion of institutional loyalty—as in director loyalty to the corporate enterprise, as distinct from loyalty only to shareholders[142]—nor

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[136]HIRSCHMAN, *supra* note 65, at 79, 98-105.

[137]Martha Nussbaum argues that, starting with Aristotle, observers of human behavior have contended that people act out of sympathy for and commitment to others as well as out of self-interest. This position, she notes "has been argued throughout the history of Western philosophy." Martha C. Nussbaum, *Flawed Foundations: The Philosophical Critique of (a Particular Type of) Economics*, 64 U. CHI. L. REV. 1197, 1211 (1997).

[138]Russell Hardin, *Law And Social Norms in the Large*, 86 VA. L. REV. 1821, 1832 (2000).

[139]*Id.*

[140]LADD, *supra* note 1, at 97.

[141]*See supra* note 64.

[142]In legal doctrine, director duties are said to be owed to the "corporation and its stockholders." *See* Lyman Johnson, *The Eventual Clash Between Judicial and Legislative Notions of Target Management Conduct*, 14 J. CORP. L. 35, 46 (1988). Professor Chapman's non-instrumentalist account of why corporate managers might care about non-shareholder constituencies (described as "corporate interests") in 1980s hostile takeover settings builds on the loyalty-shaping effect of management's sustained interactions with employees compared with more fleeting interchanges with the largely anonymous group of shareholders. Bruce Chapman, *Trust, Economic Rationality, and the Corporate Fiduciary Obligation*, 43 U. TORONTO L.J. 547, 582 (1993). To the extent director capability to do so is considered "slack" to be eliminated by

is serious attention given to the likelihood that humans do not simply satisfy *given* preferences through social/corporate interaction. Possibly, those preferences might actually be shaped by and altered through such interchanges. In the contractarian view, for Enron directors and officers to be loyal to Enron as a company is ludicrous.

Moreover, the "nexus of contracts" theory wrongly regards all social relations, including corporate relationships, as entirely voluntary. Many social groupings are consensual only to the extent that exit is not exercised.[143] A young child does not choose or in any meaningful way "voluntarily" associate with his or her family, and although workers may choose their employer, they often do not select their co-workers, bosses, customers, suppliers, or the host of other persons encountered in the workplace.[144] Stockholders and directors likewise do not "voluntarily" associate with the myriad persons comprising the corporate enterprise. Yet, in each case, many such actors for reasons not entirely or even predominantly economic, routinely display loyalty never asked for or even remotely expected, thereby enriching the lives around them. Joseph, sold into slavery by brothers he did not choose, loyally provided for them years later.[145] Moral language not only expresses the human capacity *for* such conduct, it invites us to respond *to* such conduct. We discover an inner resonance with such selfless conduct and learn (or at least wonder whether) we too can, at least occasionally, transcend self-centeredness. An Enron director or officer who regularly hears moral language can morally reflect, and can then consider what the morally correct, rather than the expedient, course of conduct might be.

In the end, Easterbrook and Fischel have no patience for a moral dimension to loyalty in their account of corporate law for the simple reason that, in their view, it serves no purpose.[146] Neither loyalty nor any other

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bolstering shareholder influence through various corporate governance measures, including fiduciary law, the opportunities for director demonstration of loyalty to non-shareholders may decline. This legal change, in turn, may reduce the corporate institution's capacity to inculcate a norm of loyalty running in favor of any group other than shareholders. The norm itself may then wither. On the other hand, to the extent corporate law tolerates "slack" in how directors act, it preserves room for fostering loyalty.

[143]As Professor Chapman notes with respect to Albert Hirschman's view: "Loyalty raises the costs of exit for committed members so that they will not exit at the first opportunity promising a higher rate of return." Chapman, *supra* note 142, at 588 n.78.

[144]"C.S. Lewis once said one of the great benefits of involuntary communities—including the family—is that "they enable us to discover the virtues of people whom we might never have chosen to hang out with." Dinesh D'Souza, *No Substitute for the Real Thing*, THE CHRISTIAN SCIENCE MONITOR 9 (Oct. 30, 2000).

[145]*Genesis* 45:1-15. *See supra* note 127 and accompanying text.

[146]Easterbrook & Fischel, *supra* note 117, at 434.

moral qualities are necessary in an instrumental "worldview whose moral center is the autonomous self and whose moral ends are personal well-being."[147] By triumphantly asserting that moral rhetoric is more "a proposition about judges rather than about rules,"[148] they fail to see what a relief that is. Less smitten by rules in the fiduciary area than Easterbrook and Fischel, and believing judges can and should infuse fiduciary law with widely-shared cultural norms,[149] this article applauds what they decry. Moreover, if their point is that modes of discourse reveal normative tilt, then their preferred mode of economic discourse is itself "a proposition about" their own normative preferences, rather than an entirely accurate description of socially and morally complex human relationships.

This second matter, the nature of social bonds in the corporation, is closely linked to the first matter of whether we conceive the corporate director wholly as an instrumentally rational economic agent or as a more complex moral actor. If human interaction within the corporation is only, or primarily, understood as financial/economic and calculating in nature, then moral, sociological, psychological, and historical discourse about director duties in evocative terms like "care" and "loyalty" is as out of place as talk of balls and strikes at a football game. A conspicuous difference for modern corporate law, however, is that for many decades the core terms of fiduciary discourse—care and loyalty—have not been those of a specialized sub-vocabulary but rather are drawn from the larger sphere of moral-social discourse.[150] There, the core notions have a rich and shared (but still open-ended) meaning, rather than a thin and peculiar significance.

The historic decision within corporate law initially to deploy a moral vocabulary suggests a view that a moral subject matter was under

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[147]HUNTER, *supra* note 57, at 160. Professor Hunter goes on to report the results of a study relating how children's underlying moral outlook shaped behavior. In that study, the children most likely to cheat, lie, steal, and least likely to express restraint in sexual matters or show compassion toward others, were expressivists and utilitarians. *Id.* at 163-70.

[148]Easterbrook & Fischel, *supra* note 117, at 434.

[149]As stated by former Chancellor William Allen: "[C]orporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as part of a larger body of law premised upon shared values." City Capital Assocs. Ltd. P'ship v. Interco, Inc., 551 A.2d 787, 799-800 (Del. Ch.), *appeal dismissed as moot*, 556 A.2d 1070 (Del. 1988).

[150]Numerous fiduciary cases in the nineteenth century and first half of the twentieth century, for example, cited the biblical prohibition against serving two masters in their discussions of loyalty. *See, e.g.*, Beasley v. Swinton, 24 S.E. 313, 322 (S.C. 1896); *see* Harlan Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 8 (1934) (commenting on the fiduciary principle of loyalty, "the precept as old as holy writ, that 'a man cannot serve two masters'"). With respect to how morality pervades fiduciary law, Tamar Frankel cogently notes: "Courts regulate fiduciaries by imposing a high standard of morality upon them. This moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor form its basic vocabulary." Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 829-30 (1983).

consideration.[151] Having inherited that vocabulary, the question for modern corporate fiduciary scholarship after twenty-five years of intense absorption with law and economics is whether to continue to explore director duties in the fullness of customary moral terms.[152] Likewise, judges facing the task of deciding whether director wrongdoing implicates loyalty rather than care must choose whether to embrace or renounce the fullest meanings of those norms. Through all the dynamic tumult in corporate law since the 1970s, the core vocabulary of "loyalty" and "care" has endured. Advocates of renouncing the received vocabulary, or of translating it into a dialect of finance/economic or game theory talk, believe either that corporate law discourse should no longer draw on terms with larger social-moral significance or that those terms are passé and meaningless in that larger sphere as well. The consequences of translating moral problems into the alluring and seemingly precise language of a utilitarian or quantitative calculus are captured by philosopher Roger Scruton:

> Those who wish to reduce such [moral] reasoning to an econometric calculation rid the moral question of its distinctive character, and replace it with questions of another kind—questions concerning "preference orderings," "optimizing" and "satisficing" solutions, and rational choice under conditions of risk and uncertainty. By shaping the moral question so that it can be fed into the machinery of economics, we do not solve it. On the contrary, we put a fantasy problem for experts in place of the painful reality of moral choice. If the answer to moral questions were really to be found in decision theory, then most people would be unable to discover it. In which case morality would lose its function as a guide to life, offered to all of us by the fact of reasoned dialogue.[153]

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[151]David Sciulli points out that Edward Rock's use of religious metaphors to describe the conduct of equity courts is apt because the first English chancellors were clerics. DAVID SCIULLI, CORPORATE POWER IN CIVIL SOCIETY 371 n.44 (2001).

[152]For former Chancellor William Allen's argument that directors are "members of *moral communities* with allegiances to *moral codes*," see William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Corporate Law*, *in* COMPARATIVE CORPORATE GOVERNANCE 330 (State of the Art and Emerging Research, Klaus J. Hopt et al., eds. 1998). For another approach to exploring the role of morality—specifically, moral desires—in corporate governance, see Thomas W. Dunfee, *Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROBS. 129 (Summer 1999).

[153]SCRUTON, *supra* note 133, at 124.

The renderings given to the term "loyalty" in the years ahead—as the full ramifications of Enron are more widely debated—will reflect far more than shared adherence to or rejection of a singular economic *description* of the corporation. They will, to the extent corporate law still draws on deeper social currents, measure as well the continued strength of a social-moral *preference* for loyal, care-giving conduct. This is true outside and within corporate law discourse. This is especially so after Enron.

IV. JUDGING AND THE NOTION OF DUE LOYALTY

A. *Interpretive Judging*

Continuing judicial exploration of the contours and boundaries of the duty of loyalty is inevitable. This is true, in part, because lawyers for unhappy stockholders will argue that director misconduct should be characterized as falling within one of the four exceptions to section 102(b)(7) and similar statutes, thereby permitting an award of monetary damages.[154]

Initially, there is the question of statutory interpretation. What do the four exceptions mean?[155] Specifically, how does the first "duty of loyalty" exception in the statute differ from the second exception for acts or omissions "not in good faith" or which involve "intentional misconduct," and from the fourth exception "for any transaction from which the director derived an improper personal benefit?"[156] Delaware courts have branded conduct falling within the second ("not in good faith") exception as implicating loyalty,[157] which was recently illustrated by alleged bad faith disclosure violations.[158] Likewise, the fourth ("improper personal benefit")

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[154]*See supra* note 12.

[155]*See supra* note 12.

[156]*See supra* note 12.

[157]Gaylord Container S'holders Litig., 753 A.2d 462, 475-76, n.41 (Del. Ch. 2000) (analyzing relationship between good faith and loyalty). *See* Nagy v. Bistricer, 770 A.2d 43, 48-49 n.2 (Del. Ch. 2000). The chancery court reasoned that:

> [i]f it is useful at all as an independent concept, the good faith iteration's utility may rest in its constant reminder (1) that a fiduciary may act disloyally for a variety of reasons other than pecuniary interest, and (2) that, regardless of his motive, a director who consciously disregards his duties to the corporation and its stockholders may suffer a personal judgment for monetary damages for any harm he causes.

Id.

[158]Johnson v. Shapiro, No. 17,651, 2002 Del. Ch. LEXIS 122, at *29-*31 (Del. Ch. Oct. 18, 2002), *reprinted in* 28 DEL. J. CORP. L. 372, 373 (2003) (providing that reckless failure to disclose may constitute bad faith); O'Reilly v. Transworld Healthcare, Inc., 745 A.2d 902, 915 (Del. Ch. 1999) (providing that "[w]here a complaint alleges or pleads facts sufficient to support

exception, as illustrated by director self-dealing transactions, has been described as raising a loyalty issue.[159] Yet, in the statute itself, the loyalty exception explicitly is set apart from those two categories of conduct. This suggests a broader scope for the duty of loyalty that includes (but is not limited to) bad faith and self-dealing, and the possibility it is amenable to a more expansive reading.[160]

A recent example of giving the loyalty exception in section 102(b)(7) a fuller reading is a chancery court decision holding that personally disinterested directors of a parent corporation also serving on the board of a subsidiary may not take action at the subsidiary level that is disloyal to the parent.[161] The court stated that directors of a parent corporation have a duty, in such a situation, to act in the best interests of the parent.[162] A "supine reaction" by the directors supports a claim for breach of the duty of loyalty.[163] The court reasoned that any other approach would "gut the duty of loyalty."[164] Additionally, Vice Chancellor Jacobs' recent opinion in *Emerald Partners v. Berlin*,[165] after remand, addressed director loyalty where there was neither a personal nor a positional conflict. Among other claims, plaintiff-stockholders charged that four of the five directors had breached their duty of loyalty in approving a merger between the corporation and thirteen other corporations controlled by the fifth director who also was the CEO.[166]

As noted by the court, the non-affiliated directors had no adverse personal interest in the merger, and they received no benefit from that

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the inference that the disclosure violation was made in bad faith, knowingly or intentionally, the alleged violation implicates the duty of loyalty").

[159]Grace Bros. Ltd. v. Uniholding Corp., No. 17,612, 2000 Del. Ch. LEXIS 101, at *35-*36 (Del. Ch. July 12, 2000), *reprinted in* 27 DEL. J. CORP. L. 304, 331 (2002). The court noted:

> Arguably, the improper personal benefits provision of § 102(b)(7)(iv) could be seen as preventing a director from benefiting from his own gross negligence in the context of a self-dealing transaction, but this, too, can properly be seen as raising loyalty concerns, given that it involves a fiduciary who has personally benefited from his own lack of care . . . .

Id.

[160]United States v. Menasche, 348 U.S. 528, 538-39 (1955). In interpreting a statute, it is the court's duty to "give effect, if possible, to every clause and word of a statute." *Id.*

[161]*Grace Bros. Ltd.*, 2000 Del. Ch. LEXIS 101, at *40, *reprinted in* 27 DEL. J. CORP. L. at 322.

[162]*See id.*

[163]*See id.*

[164]*See id.* at *41, *reprinted in* 27 DEL. J. CORP. L. at 323.

[165]No. 9700, 2001 Del. Ch. LEXIS 20 (Del. Ch. Feb. 7, 2001), *vacated and remanded*, 787 A.2d 85 (Del. 2001).

[166]*Id.* at *65.

transaction other than as shareholders of the company.[167] Nor did the plaintiff claim that the non-affiliated directors, because of material financial or personal relationships, were disabled from acting independently of the CEO or in the company's and its public stockholders' best interests.[168] Equally, there was no basis to assert that the directors were under the CEO's control, as all directors were independent, successful businessmen long before they met the CEO, and none was beholden to him.[169] In this non-conflict setting, the plaintiff's duty of loyalty claim rested squarely on the theory of director "'indifference to their duty to protect the interests of the corporation and its minority shareholders,'"[170] a theory recently recognized in *Strassburger v. Earley*.[171]

Vice Chancellor Jacobs first distinguished *Strassburger* by noting that in that case two of four directors worked as well-paid employees of the majority shareholder, which had sold its controlling stock interest back to the corporation.[172] This sale enlarged the president's personal stock ownership position from 6.9% to 55%.[173] Although they did not personally gain from the repurchase, the *Strassburger* court found that the loyalty of the two directors to their employer had made them "indifferent" to their duty of loyalty to protect the corporation and its minority stockholders.[174] In contrast, the *Emerald Partners* court found that the merger in that case did "benefit all May stockholders,"[175] and that there was no evidence the non-affiliated directors had acted "other than with the best interests of the minority shareholders in mind."[176] Indeed, Vice Chancellor Jacobs found that the directors' decisions had affirmatively furthered the interests of the minority stockholders.[177]

The *Emerald Partners* court clearly acknowledged the affirmative thrust of loyalty; however, it found that directors had fulfilled that duty.[178]

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[167] *Id.*

[168] *Id.*

[169] *Emerald Partners*, 2001 Del. Ch. LEXIS 20, at *65.

[170] *Id.* at *69 (quoting Strassburger v. Earley, 752 A.2d 557, 581 (Del. Ch. 2000)).

[171] 752 A.2d 557, 581 (Del. Ch. 2000).

[172] *Id.*

[173] *Id.* at 561, 564.

[174] *Id.* at 581.

[175] *Emerald Partners*, 2001 Del. Ch. LEXIS 20, at *80.

[176] *Id.* at *82.

[177] *Id.* at *84.

[178] *Id.* at *85. The Delaware Supreme Court reversed on the ground that the chancery court had allowed the company's exculpatory provision to unduly limit its level of judicial scrutiny, holding that such a provision should only be considered where "entire fairness" is the standard after a liability determination has been made. Emerald Partners v. Berlin, 787 A.2d 85 (Del. 2001).

Imagine such an affirmative conception of loyalty on the *Strassburger* facts but *without* the dual director loyalty existing in that case. Vice Chancellor Jacobs' emphasis on the benefit to minority stockholders suggests that the affirmative dimension of director loyalty would not have been fulfilled in *Strassburger* on those facts.[179] A recent illustration of this arose where a plaintiff-stockholder described as "faithless" the behavior of a disinterested director in allowing the CEO/director to take personally an opportunity to purchase thirty percent of the corporation's stock for $1,000 at a time when it was worth substantially more.[180] By not acting to pursue the opportunity for the corporation itself, the director ignored "a particularly striking 'opportunity' for the corporation to benefit its stockholders."[181] In *Kohls*, Vice Chancellor Lamb, noting plaintiff's reliance on *Strassburger* to contend that the director's "inexplicable indifference to the interests of the Company in this matter . . . implicate[s] his duty of loyalty," denied a motion to dismiss after concluding the director faced a substantial likelihood of personal liability for breach of fiduciary duty.[182]

As shown by these illustrative cases, the interpretive task ultimately requires courts to confront the central issue addressed in this article: What does loyalty mean in corporate law and what materials will be drawn on to answer this question? Corporate law discourse[183] contains both the minimal and maximal strands of loyalty, though the former is considerably more developed. Moreover, at a philosophical level it is hard to draw a sharp boundary between robust conceptions of loyalty and care, though for reasons quite different than those stated by Easterbrook and Fischel.[184] This suggests that contemporary corporate law has neither a singular, fully-developed notion of loyalty nor a settled view of the precise borderline between the duties of care and loyalty. These matters are for the first time in the process of being worked out as courts, against the backdrop of corporate scandal and Congress's response to it,[185] must say with greater precision what sort of director misconduct implicates loyalty (allowing damages) and what sort implicates only care (prohibiting damages). Before enactment of section 102(b)(7), it was enough to find a fiduciary breach of

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[179] *Strassburger*, 752 A.2d at 581.

[180] *See, e.g.*, Kohls v. Duthie, 791 A.2d 772, 778 (Del. Ch. 2000), *rev. ref'd*, 765 A.2d 950 (Del. 2000).

[181] *Id.* at 784. *See* Bomarko, Inc. v. International Telecharge, Inc., 794 A.2d 1161, 1178 (Del. Ch. 1999) (reasoning that a director is disloyal where his actions "interfered with the other directors' efforts to benefit . . . shareholders"), *aff'd*, 766 A.2d 437 (Del. 2000).

[182] *Kohls*, 791 A.2d at 782.

[183] *See supra* text accompanying notes 38-50, 79-90.

[184] *See supra* notes 31, 117.

[185] *See* Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266 (2002).

some sort, at least for purposes of awarding damages, whether it was grounded in care, loyalty or both.

B. *Policy Judging*

Realizing that corporate law has not finished grappling with the task of articulating the full reach of loyalty (and its relationship to care), and that philosophical, artistic, and sociological sources suggest this duty is a rich notion, how do judges actually stake out a sensible dividing line between care and loyalty? This raises a threshold policy question. Are there (or might there be) instances of director wrongdoing in addition to breach of the minimal condition of loyalty that should be sanctionable by an award of money damages on policy grounds? Might shareholders *ex ante* find this desirable? Does this first require a clearer reckoning of the gains from such a possibility as weighed against possible losses, such as discouraging highly qualified prospective director candidates and inducing incumbent directors to engage in overly risk-adverse behavior.[186] Put another way, does section 102(b)(7) leave too much director misconduct unsanctionable by damages if loyalty is narrowly construed to mean only the avoidance of director self-gain?[187]

This raises the issue of the proper role of monetary sanctions for director misconduct in a sound corporate governance regime. This was precisely the issue triggered by *Smith v. Van Gorkom*[188] in 1985, promptly addressed in 1986 by passage of section 102(b)(7), and in 2003 still lurking beneath the surface as judges seek to categorize wrongdoing as "care" or "loyalty" in nature.[189] Will we get better conduct from Enron directors if they face some appreciable risk of monetary sanctions, or will such a risk make it more difficult to attract high-quality directors, resulting in poorer corporate governance? If monetary damages are thought in certain settings to be inappropriate on policy grounds, then the statutory exception for the "duty of loyalty" should be given a narrow reading. This would be done by

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[186]In this regard, given that § 102(b)(7) is an opt-in provision, one wonders both what was (and is) said to stockholders about the kind of director conduct still sanctionable by damages when stockholders are asked to consent to adoption of exculpation. Also, one wonders what stockholders think is being given up—and what is being retained—by way of ability to sue directors for damages. At a minimum, directors seeking shareholder approval must fulfill their duty of disclosure. *See supra* note 46. Beyond that, one wonders what the parties believe is being relinquished and retained.

[187]*See supra* notes 70-73 and accompanying text.

[188]488 A.2d 858 (Del.1985).

[189]This issue will emerge as central when the interaction of the federal Sarbanes-Oxley Act's mandates for corporate directors and state law fiduciary standards raises director liability questions.

limiting loyalty to the minimum condition, by reading the duty of care broadly, or both. On the other hand, there *might be* a subset of director conduct that, although not characterizable as either a breach of process-oriented due care or the betrayal aspect of loyalty, should be *sanctionable* (not the same as always being *sanctioned*) by damages. Preserving judicial discretion to sanction such conduct will require a broader construction of loyalty. This would be done both by interpreting loyalty as going beyond nonbetrayal and reading care narrowly to mean only the process-oriented duty to act "with care." This approach leaves at least portions of the "take care of" and "care for" dimensions of director responsibility to the realm of affirmative loyalty.[190] To the extent these responsibilities are housed within the duty of loyalty, their breach will subject directors to the risk of monetary damages.

The issue of whether loyalty should be construed to have minimum and maximum dimensions is not entirely dependent on the appropriateness of money damages for breach of director loyalty. One possible approach is to allow damages for breach of the minimum condition, but to allow no damages or a capped or formulaic dollar amount (e.g., return of the past year's director compensation) for other breaches of loyalty. Another possibility is to consider a board's (or individual director's) state of knowledge. A director who deliberately neglects or deliberately violates known duties is a stronger candidate for a monetary sanction than one less culpable.[191] Each of these approaches would usefully acknowledge the fullness of the duty of loyalty while reserving money damages for only a subset of loyalty violations. In that event, a noncompensable breach of loyalty would, as with a breach of care, support equitable relief or amount to an infringement of a legally recognized but non-legally enforceable norm.[192] Currently, the duty of loyalty exception in section 102(b)(7) and other similar statutes does not distinguish among types of loyalty breaches.[193] To the extent a rich duty of loyalty is thought to be

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[190] *See supra* notes 98-112 and accompanying text.

[191] Vice Chancellor Leo Strine made this point to the author. Professor Anderson, *supra* note 31, at 758 n.59, also notes that disloyalty may be regarded as more "unfair" than laziness or carelessness because it involves a "more deliberate form of self-preference." The element of deliberateness may, as the vice chancellor suggests, serve as one partial "marker" for identifying conduct as raising a loyalty issue for purposes of sanctioning inappropriate conduct.

[192] Professors Edward Rock and Michael Wachter have coined the phrase "nonlegally enforceable rules and standards" to express this idea. *See* Edward Rock & Michael Wachter, *Islands of Conscious Power: Law, Norms and the Self Governing Corporation*, 149 U. PA. L. REV. 1619 (2001).

[193] *See supra* note 12.

normatively desirable,[194] but also that not all such breaches should support damages, the statutory loyalty exception is overinclusive and should be amended. The exception might be modified so that damages are permitted only where directors directly or indirectly procured gain from their breach, or where they deliberately or recklessly acted wrongly.

The availability of only equitable relief for breach of affirmative loyalty actually may serve to induce judges to give that duty a broader reading and stricter enforcement. Just as judges might be more inclined to upgrade corporate practice by finding care breaches if only equitable remedies obtain, judges might more readily find loyalty breaches through a fuller reading of loyalty if such breaches supported only equitable remedies or limited damages. In interpreting section 102(b)(7) and similar statutes, judges might be overcharacterizing director misconduct as care in nature because of a policy concern about damages, even though it would be better in some instances to preserve the harsher, more potentially shameful verdict of a loyalty breach,[195] *if* that could be done without an excessive and counter-productive damage award. The thrust of this distinction is bolstered if stronger corporate disclosure rules or practices increase the likelihood that shareholders will learn about director misdeeds in sufficient time to seek equitable relief, thereby reducing the relative importance of monetary sanctions.[196]

C. *Doctrinal Judging*

Answers to some of the questions raised above may lie in well-designed empirical work. Absent empirical evidence or statutory reform, however, these sorts of policy questions will surely be on judges' minds as they decide whether particular director conduct does or does not concern loyalty. For example, is a judge likely to impose damages on a director who did not personally benefit from a disloyal decision? On the other hand, how healthy is contemporary corporate law if fiduciaries who behave

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[194]*See* Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 VA. L. REV. 1577, 1597 (2000) ("The primary way to prompt people to instill civic virtue in each other is by aligning law with morality.").

[195]Vice Chancellor Lamb has observed that "where . . . issues of loyalty are involved, potentially harsher rules come into play." Bomarko, Inc. v. International Telecharge, Inc., 794 A.2d 1161, 1184 (Del. Ch. 1999), *aff'd*, 766 A.2d 437 (Del. 2000). The supreme court also has emphasized the importance of sound remedies for disloyalty: "Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly . . . . The strict imposition of penalties under Delaware law are designed to discourage disloyalty." Thorpe v. CERBCO, Inc., 676 A.2d 436, 445 (Del. 1996).

[196]Professor Adam Pritchard made this point to the author. It remains to be seen if stricter corporate disclosure practices under the Sarbanes-Oxley Act will have this effect.

disloyally do not face some risk of reasonable monetary damages? Judicial probing of these issues will be enhanced by a mode of discourse that, although rooted in history, is not mere vernacular but is capacious enough to allow growth and change. This author suggests use of the concept "due loyalty." The key loyalty inquiry is the same in corporate law as elsewhere in that "[w]e must ask what loyalty demands of a person."[197] Expressing the same idea pragmatically: "The problem is working out the limits of loyalty."[198]

The word "loyalty" comes from the French word *loi*, meaning "law."[199] Loyal behavior is behavior owed by reason of law, moral or positive. It is that which is "due" in a particular context. The requirement is not abstract. It is not compliance with a purely theoretical standard of loyalty that is demanded, but "due" loyalty which is demanded. This means the loyalty sufficient for, and properly proportioned and owed to, the particular setting.[200] James Hunter reminds us that: "Morality is *always* situated—historically situated in the narrative flow of collective memory and aspiration, socially situated within distinct communities, and culturally situated within particular structures of moral reasoning and practice."[201] Corporate law, with its distinctive vocabulary, practices, and membership, is the community where generally-shared norms (like loyalty) are discussed and implemented in a very particular institutional setting. This means the Delaware Court of Chancery, a court of equity, should frame the pertinent inquiry to be whether the director's duty of "due loyalty" was fulfilled or breached under specific circumstances. Over time, this will lead to the articulation of "rules," but these rules are simply particularized expressions

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[197]LADD, *supra* note 1, at 98.

[198]FLETCHER, *supra* note 51, at 151.

[199]LADD, *supra* note 1, at 98.

[200]Albert Hirschman distinguishes "loyalty" and "pure faith" on the ground that "loyalist behavior retains an enormous dose of reasoned calculation." HIRSCHMAN, *supra* note 65, at 78-79. Chapman draws on that conceptual distinction to assert that a loyal actor is blind to a purely instrumental calculus only to a point. Chapman, *supra* note 142, at 588 n.78. The use of "due" loyalty recognizes that admirable loyalty is neither "blind" nor the only norm shaping conduct, and therefore use of "due" loyalty eliminates the need to distinguish between loyalty and faithfulness as Hirschman uses those terms.

[201]HUNTER, *supra* note 57, at 11. The Delaware Supreme Court also recognizes that fiduciary duty is contextually specific. McMullin v. Beran, 765 A.2d 910, 918 (Del. 2000) ("[C]ommon law fiduciary responsibilities that directors of a Delaware corporation are required to discharge depends [sic] upon the specific context . . . .").

of due loyalty.[202] Loyalty itself remains a social-moral norm and a legal standard, never wholly reducible to a precise rule.

Phrasing the inquiry in that fashion avoids the dual temptation to regard loyalty as a "free-floating abstraction"[203] or a fixed recipe. Loyalty, both as a social norm and a legal duty, is like other virtues in being "malleable, and shaped by . . . circumstances . . . and requir[ing] a social setting."[204] Although susceptible to the making of some general "core" statements about them, the context-sensitive duties of corporate directors are not best likened to "allegories such as the play *Everyman* and *Pilgrim's Progress*, in which the characters represent abstractions."[205] Rather, like that "dominant flow of our artistic tradition . . . [which gives us] great works of individualization, which pause to delineate the characters not just of heroes and seers but also of children, housewives, bureaucrats, prostitutes, and tax collectors, of swineherds and old nurses and animals,"[206] the "due loyalty" inquiry focuses on whether a particular moral actor, embedded in a particular context, provided what was "due" for furthering the corporation's interests.

Framing the loyalty inquiry in this manner also achieves a certain analytical symmetry in corporate law by aligning the phrasing of the loyalty mandate with the phrasing of the care duty. The care duty, in the best

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[202]Professor Anderson makes a distinction too often forgotten, i.e., that there are fiduciary *duties* and conflict of interest *rules*. Anderson, *supra* note 31, at 760 & nn.65, 68. "Over the years more specific content has been given to fiduciary duties by establishing some general rules of behavior . . . . On the whole, however, fiduciary duties are not defined in any detail but simply require the fiduciary to act fairly in the client's interest." *Id.*

[203]HUNTER, *supra* note 57, at 11.

[204]SCRUTON, *supra* note 133, at 114-15.

[205]WENDELL BERRY, LIFE IS A MIRACLE 114 (2000). Mr. Berry goes on to remark that while literary characters "'stand for' us humans . . . they are each also intransigently themselves, and are valued as such. They all come out of the common fund of human experience, and so we recognize them, but not one of them is the same as anybody else." *Id.*

[206]*Id.* David Skeel's emphasis on the narrative (rather than strictly doctrinal) form of corporate law judicial opinions highlights the importance of individualization: "Doctrinal expositions, like the Ten Commandments or the Delaware statute, have their place; but difficult questions of good faith demand the particularities that only narrative structure can provide." David A. Skeel, Jr., *Saul and David, and Corporate Takeover Law* 151, 169 *in* LITERATURE AND LEGAL PROBLEM SOLVING (Paul J. Heald ed. 1998). Mae Kuykendall also believes that:

> [corporate law] will benefit from a guiding framework that proposes a narrative structure for a socially embedded set of stories about the sort of people who inhabit the corporate world, both the concrete setting and the legal constructs . . . [Such stories] contain nuance, accommodate complexity about human motives, avoid cant and inspire interest . . . .

Mae Kuykendall, *Comment on Kostant: Tune in to hear stories of corporate governance, the adventure of the go-between and more exciting tales of corporate law*, 28 J. SOCIO-ECON. 259, 263 (1999).

opinions,[207] is described as the duty of "due care." This rightly acknowledges the context-specific, equitable nature of fiduciary inquiry. The same should hold true for loyalty, preserving that domain against capture by either a substantive rule-based or an entirely process-oriented "one size fits all" mindset.[208]

Expressing the analysis as an exploration of "due loyalty" accurately captures the formative nature of what courts are being asked to do in interpreting section 102(b)(7) and similar statutes. Courts must cultivate a sensibility for deploying the one remaining robust duty—loyalty—to serve as the mainstay of corporate fiduciary law's imposition of monetary sanctions. Classifying director wrongdoing as care or loyalty requires, as noted above, that certain interpretive and policy issues be addressed, including a determination of whether customary policy rationales for judicial deference in the care context apply in particular instances. If nonliability for misconduct is necessary to induce appropriate risk-taking behavior on the part of directors or to attract high-quality persons to serve as directors, then a court is more likely to characterize the wrongdoing as constituting a care breach.[209] If those rationales do not apply—and interpreting section 102(b)(7) may afford an opportune occasion for finally taking a hard look at whether those rationales truly apply to the duty of care or only to the more modest business judgment rule[210]—then a court is more likely to consider classifying the misconduct as raising a loyalty issue. Furthermore, as noted earlier,[211] the deliberativeness of director conduct is an appropriate consideration in framing whether conduct raises a loyalty or care concern.

Beyond a capacity to accommodate policy concerns, however, the concept of "due loyalty," to be useful for judging, must be fitted into existing procedural practice, such as allocation of the burdens of pleading and proof and standard of judicial review. For example, the Delaware Supreme Court recently stated that the shield from liability provided by

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[207]*See, e.g.*, Brazen v. Bell Atlantic Corp., 695 A.2d 43, 49 (Del. 1997) ("The business judgment rule is a presumption that directors are acting independently, in good faith and with due care in making a business decision."); Ryan v. Tad's Enters., Inc., 709 A.2d 682, 689 (Del. Ch. 1996) ("[O]ur law presumes that in making a [business] decision . . . , the directors acted with due care and in good faith to advance the best interests of shareholders.").

[208]*See* Victor Brudney, *Revisiting the Import of Shareholder Consent for Corporate Fiduciary Obligation*, 25 J. CORP. L. 209 (2000) (criticizing procedural approach to loyalty).

[209]Goodwin v. Live Entm't, Inc., No. 15,765, 1999 Del. Ch. LEXIS 5, at *76 n.17 (Del. Ch. Jan. 22, 1999), *reprinted in* 24 DEL. J. CORP. L. 1084, 1129 n.17 (1999), *aff'd* 741 A.2d 16 (Del. 1999).

[210]*See* Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625 (2000).

[211]*See supra* note 191 and accompanying text.

section 102(b)(7) is in the nature of an affirmative defense and that defendants bear the burden of establishing each of its elements.[212] Thus, defendants must demonstrate compliance with the duty of loyalty unless "the factual basis for a claim *solely* implicates a violation of the duty of care."[213]

Two Delaware Supreme Court decisions have brought some clarity and introduced additional uncertainty.[214] *Malpiede v. Towson* clarified that:

> although an exculpatory charter provision is "in the nature of an affirmative defense," simply proving the existence of a valid exculpatory provision in the corporate charter entitles directors to a dismissal of any claims for money damages against them that are based on alleged breaches of the duty of care.[215]

Thus, where only duty of care violations are alleged, no determination of liability at trial is necessary and pretrial dismissal is appropriate. In *Emerald Partners v. Berlin*, however, the supreme court reversed the lower court decision because it had considered the effect of an exculpatory charter provision before determining liability.[216]

The court in *Emerald Partners* distinguished *Malpiede* as involving a business judgment rule standard of review while in *Emerald Partners* the standard "*ab initio*" was "entire fairness."[217] The court ruled that where the latter standard applies, liability can only be determined by a judicial finding that "entire fairness" is lacking and a judicial articulation of which duty or duties were breached such that unfairness resulted.[218] If the duty breached was the duty of care, only then will the exculpatory provision be a bar to damages.

The supreme court's suggested reconciling of its two decisions based on the applicable standard of review is not entirely satisfactory. Under

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[212]McMullin v. Beran, 765 A.2d 910, 926 (Del. 2000); Emerald Partners v. Berlin, 726 A.2d 1215, 1224 (Del. 1999). *But see* MODEL BUS. CORP. ACT § 8.31 (assigning burden to plaintiff). For a discussion of the Model Act's approach to exculpation, see Jesse J. Hanks, Jr. & Larry P. Scriggins, *Protecting Directors and Officers from Liability—The Influence of the Model Business Corporation Act*, 56 BUS. LAW. 3, 25-28 (2000).

[213]*Emerald Partners*, 726 A.2d at 1224.

[214]Emerald Partners v. Berlin, 787 A.2d 85 (Del. 2001); Malpiede v. Towson, 780 A.2d 1075 (Del. 2001).

[215]*Malpiede*, 780 A.2d at 1095-96 n.71.

[216]Emerald Partners v. Berlin, 787 A.2d 85 (Del. 2001).

[217]*Id.* at 92-93.

[218]*Id.* at 94.

current Delaware law,[219] a breach of the duty of care rebuts the business judgment rule and results in entire fairness review. This standard would seem to trigger the liability determination called for by *Emerald Partners*. This would be a futile determination, however, since money damages cannot be collected where only care is breached.[220]

Perhaps the court means that even if sufficient facts are alleged to rebut the business judgment rule, defendants may still obtain pretrial dismissal based on an exculpatory provision if the only basis for rebutting that standard of review is a duty of care breach. Some language in the opinion supports this reading.[221] On the other hand, the court later speaks broadly to suggest that once the entire fairness standard is invoked, exculpation can be granted only after a liability determination has been made.[222] Uncertainty on the proper reading of *Emerald Partners* on this point quickly emerged in a subsequent chancery court decision.[223]

The underlying problem is that the supreme court's *McMullin* and *Emerald Partners* decisions wrongly treat section 102(b)(7) as being in the nature of an affirmative defense effecting a burden shift to defendants. Recall that in a breach of fiduciary duty claim the initial burden of proof is on the plaintiff to rebut the business judgment rule,[224] and that to meet that burden the plaintiff must "provide evidence"[225] that defendant directors breached any one of their "'triad of fiduciary duties, loyalty, good faith or

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

[220]*Emerald Partners*, 787 A.2d at 92 ("[I]f the shareholder complaint only alleges a duty of care violation, the entry of a monetary judgment following a finding of unfairness would be uncollectible.").

[221]*Id.* ("[W]hen the presumption of the business judgment rule has been rebutted in the shareholder complaint solely by successfully alleging a duty of care violation, the director defendants do not have to prove entire fairness to the trier of fact, because of the exculpation afforded to the directors . . . ."). In short, entire fairness technically is the applicable standard but directors need not carry their burden of proof because no damages could be awarded even if they fail to carry it.

[222]*Id.* at 94 ("We hold that when entire fairness is the applicable standard of judicial review, a determination that the director defendants are exculpated from paying monetary damages can be made only after the basis for their liability has been decided.").

[223]*In re* Student Loan Corp. Deriv. Litig., No. 17,799, 2002 Del. Ch. LEXIS 7, at *13 n.8 (Del. Ch. Jan. 8, 2002). Vice Chancellor Strine stated that *Emerald Partners*:

> can be read to hold that when the entire fairness standard applies, even an independent director cannot obtain dismissal of damage claims against him until after the fairness of the transaction is determined, regardless of whether the independent director shows, on a Rule 12(b)(6) or Rule 56 motion, that the plaintiffs have submitted no facts or admissible evidence, as the case may be, supporting a finding that the independent director committed a non-exculpated breach of fiduciary duties.

[224]Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162 (Del. 1995).

[225]*McMullin*, 765 A.2d at 917.

due care.'"[226] This means, contrary to the *McMullin* and *Emerald Partners* statements that defendant bears the burden of demonstrating loyalty where section 102(b)(7) is at issue, that plaintiff bears the burden of pleading and producing evidence of a breach of loyalty. The significance of plaintiff pleading and providing evidence of such a breach (or, depending on the burden allocation, a defendant failing to prove that conduct is care in nature) is that a breach of loyalty rebuts the business judgment rule's presumption that the directors have acted in the best interests of the shareholders.[227] The result not only is the possibility of money damages but also that directors must prove their action was entirely fair.[228] Plaintiff's failure to provide evidence of disloyalty (or, depending on the burden allocation, defendant's success in proving either that conduct is care in nature or that it *fulfilled* its loyalty duty) means that money damages will be unavailable due to section 102(b)(7), and that the substance of director conduct will not be reviewed for fairness[229] but only for rationality.[230]

The supreme court clearly needs to re-address how the protection of section 102(b)(7) meshes with procedural burdens and existing standards of review.[231] This is important because of judicial efficiency concerns and because burdens and standards of review often are outcome

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[226]*Gaylord Container S'holders Litig.*, 753 A.2d 462, 475-76 n.41 (Del. Ch. 2000) (quoting *Cede & Co.*, 634 A.2d at 361).

[227]Cede Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1993).

[228]*Cinerama, Inc.*, 663 A.2d at 1162-63.

[229]Vice Chancellor Jacobs, having found that defendants in *Emerald Partners* had proven they did not breach their duty of loyalty, did not go on to conduct an "entire fairness" review. *Emerald Partners*, 2001 Del. Ch. LEXIS 20, at *68. This was proper in that case because the supreme court had broadly instructed him to place the burden on defendants. On appeal, the supreme court saw it differently and remanded. On remand, the court of chancery must first make a determination under the entire fairness standard of review. If the court determines that the transaction was entirely fair, the director defendants have no liability for monetary damages. If the court determines that the transaction was not entirely fair, only then should it address the § 102(b)(7) charter provision. The court must consider the director defendants' § 102(b)(7) request for exculpation in the context of the court's finding of unfairness. If director defendants can establish that the court's finding of unfairness is exclusively attributable to a violation of the duty of care, then they can avoid personal liability for paying monetary damages. Emerald Partners v. Berlin, 787 A.2d 85, 91-93 (Del. 2001).

[230]Even under Delaware's business judgment rule review standard, a board decision must have a "rational business purpose." Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1373 (Del. 1995). An "irrational" decision "may tend to show that the decision is not made in good faith." Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000). This approach avoids Chancellor Allen's valid policy concern about courts directly reviewing the substance of board actions, even under a mild "rationality" standard. *In re* Caremark Int'l Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

[231]*See supra* notes 229-30 and accompanying text.

determinative.[232] Apart from that issue, the supreme court should address how the proposed concept of "due loyalty" fits into the existing procedural scheme and standards of judicial review for addressing alleged fiduciary duty breaches.

Where plaintiff's properly pled claim is that directors breached the minimum condition of loyalty by, for example, a majority of the directors engaging in self-dealing, those directors would, as under existing law, bear the burden of proving entire fairness to the court's satisfaction.[233] Judicial review is rather invasive in this instance because widespread director conflict deprives the stockholders of a "neutral decision-making body."[234] However, where plaintiff contends that director misconduct is not self-interested in nature, yet violates the affirmative dimension of loyalty as in *Emerald Partners*, he should retain the burden to prove directors breached their duty of "due" loyalty. Shareholders contending that director fiduciary duties involve more than acting with procedural care and more than refraining from self-gain should have both the conceptual and procedural opportunity to do so. However, they should also bear the legal burden to convince a court that, in a particular context, directors have failed to act with "due loyalty." The question that arises is what standard of review should courts apply to this burden? The only judicial standard of review for assessing a plaintiff's claim, outside of the control change setting,[235] appears to be business judgment review. The question now is how can a shareholder overcome that director-friendly standard?

Recall how Delaware formulates the business judgment rule: "[A] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[236] Director conduct not involving a business decision—whether it is a decision to take an action or not take an action[237]—will not be reviewed under that standard. Thus, director abdication or failure to discharge responsibilities is not reviewed under a business judgment standard.[238]

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[232]Stroud v. Grace, 606 A.2d 75, 90 (Del. 1992).

[233]Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995).

[234]Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 42 n.9 (Del. 1994); *Cinerama, Inc.*, 663 A.2d at 1170.

[235]*QVC*, 637 A.2d at 42.

[236]Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[237]*Id.* at 813.

[238]For example, a director charged with breach of loyalty for failure to pursue an extraordinary opportunity for the corporation to purchase its own stock at a substantial discount made no business decision entitling him to review under the business judgment rule standard. Kohls v. Duthie, 791 A.2d 772, 780 (Del. Ch. 2000), *rev. ref'd*, 765 A.2d 950 (Del. 2000). *See*

Moreover, such behavior might be regarded not only as a duty of care breach but also, at least if reckless, as a breach of "due loyalty."[239] As a procedural presumption, the business judgment standard can be overcome by plaintiff's showing of a breach of loyalty.[240] This is because a breach of loyalty rebuts that element of the business judgment rule that presumes "directors have acted in the best interests of the shareholders."[241]

A shareholder should be free to make that showing other than in instances concerning director conflict of interest or self-dealing. The duty to advance corporate and shareholder interests is, after all, the affirmative thrust of loyalty,[242] and it exists as an additional obligation to the director duty to act fairly when engaged in self-dealing. It should remain open to a stockholder to prove that, in the totality of the circumstances, disinterested director conduct was not a fulfilling of the loyalty "due" in that situation. Successfully making that showing would either lead outright to director liability for proven damages or, under the constraint of the *Cede* framework, perhaps simply shift to defendant the burden to prove that its conduct was "fair." This is not to say that courts in reviewing this issue will, or should, lightly disregard board action. It only suggests that it should remain open for a shareholder to prove that deference should not automatically be given to the board action. The policy importance of judicial deference remains intact, but it is not the only consideration, nor is it conclusive where other factors outweigh it.

A measure of this substantive judicial safeguarding exists already, although not under this rubric. The requirement that a business judgment be substantively "rational" reflects judicial unwillingness to defer *carte blanche*.[243] This might be considered a way of inferring a bad faith motive,[244] or a substantive facet of care, but since that latter duty largely, if not exclusively, is process-oriented, the rationality requirement is better viewed as a way of assuring a modicum of affirmative loyalty.[245] Once

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Rales v. Blasband, 634 A.2d 927, 933-34 (Del. 1993) (finding no business judgment rule review "where the subject of the derivative suit is not a business decision of the board").

[239] *See supra* text accompanying notes 38, 43.

[240] Cede Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1993).

[241] *Id.*

[242] *See supra* accompanying notes 80-90.

[243] *See supra* notes 151, 230.

[244] *See supra* notes 151, 230.

[245] This is bolstered by the view that the obligation of good faith is itself an aspect of loyalty. *See* Gaylord Container S'holders Litig., 753 A.2d 462, 475-76 n.41 (Del. Ch. 2000). Perhaps the element of good faith can supply a doctrinal vessel for at least capturing the more affirmative thrust of loyalty. *See* Nagy v. Bistricer, 770 A.2d 43, 48-49 n.2 (Del. Ch. 2000); *supra* notes 112, 151 & 230.

some degree of substantive judicial review is permitted, the business judgment rule is seen not to be an insurmountable procedural or substantive barrier. The real question becomes why the standard is both set so low (no "rational" basis) and across the board, rather than in a manner both more open-textured and context-sensitive, as with the phrasing "due loyalty." In effect, as a framework for guiding fiduciary review, the business judgment rule becomes a rebuttable presumption that directors acted with due care and due loyalty, a presumption plaintiff can substantively overcome on a well-supported loyalty claim.[246]

The notion of "due loyalty" honors the equitable nature of fiduciary duties as well as the context-sensitive judicial task of determining breach or fulfillment of such duties. The concept recognizes that there are strong policy considerations against both damage awards and non-deferential review standards while leaving open the possibility for a stockholder to persuade a court that specified (non self-dealing) misconduct should be treated as a loyalty breach. This upholds the traditional responsibility of "the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity . . . distinguishe[s] it."[247] Equity remains as "the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims."[248] Although the predictability and certainty that accompany an approach confining loyalty to the minimum condition are desirable, they are not the only legal virtues, and it will be impossible to reduce equity—or an equitable notion like "due loyalty"—to a clear rule. As Aristotle noted upon explicating the necessity for equity as an antidote to the universality of legal rules: "[T]he rule of the undefined must be itself undefined also."[249] The judicial task here remains the vital one of fleshing out what loyalty means—and how it differs from due care—through frequent instances of saying whether particular conduct did or did not fulfill that norm/duty.

This is not to say that filling out the duty of "due loyalty" should be limited to judicial monitoring of director practices through shareholder litigation of fiduciary concerns. Perhaps certain structural changes in corporate governance will accompany the elaboration of due loyalty, as

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[246]*See Cede & Co.*, 634 A.2d at 371.

[247]Hecht Co. v. Bowles, 321 U.S. 321, 329-30 (1944).

[248]*Id.* at 329-30.

[249]ARISTOTLE, NICOMACHEAN ETHICS 142 (Martin Ostwald trans., Bobbs-Merrill Co., Inc.,1962) (n.d.).

some have advocated for due care.[250] Taking on fewer directorships may permit more affirmative devotion to the interests of a specific corporation. Declining directorships of companies that would detract from loyalty to a particular corporation may be necessary to accord that corporation the loyalty it is "due." Requiring significant stock ownership by directors may serve salutary purposes with respect to fulfillment of the duty of loyalty as well as the duty of care.[251]

Finally, just as care remains a legal duty notwithstanding the judicial deference housed in the business judgment rule,[252] affirmative loyalty to corporate interests also is a legal duty, notwithstanding much judicial emphasis on the minimal need only to refrain from disloyal conduct. Therefore, lawyers counseling directors in the decision-making context can (and should) emphasize the affirmative dimension of loyalty, stressing the importance of identifying and then doing what is *best* for the enterprise, and not simply advising directors to refrain from *disloyal* behavior. In post-Enron boardrooms, legal counsel should advise directors that they have a legal duty of loyalty that demands their considered judgment of what is *best* for the corporation, not merely a duty to do what is acceptable or all right, or, worse yet, a duty only to avoid certain conduct. To aid in this professional discourse, corporate law professors also bear responsibility.[253] They should be careful not to truncate loyalty for law students by couching discussion of it solely in terms of avoiding self-gain, thereby leading future lawyers to internalize a professional norm "smaller" than the norm prevailing outside legal discourse.[254] By hearing counsel explain how to be authentically loyal and how to fulfill their duty of care, directors can bring to these words their own recollection of teaching, stories, drama, poetry, preaching, personal experience, and other sources where the exemplary norm, of loyalty and care were modeled and transmitted. Such "legal" advice serves to remind the hearer of a richer, moral-social meaning, which can result in director action going beyond the liability-avoiding legal minimum. By infusing the concepts of care and loyalty with social-moral-experiential meaning, lay people may endow the concepts of care and

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[250]R. Franklin Balotti et al., *Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?* 55 BUS. LAW. 661 (2000).

[251]*Id. But cf.* Gene Koretz, *Money Can't Buy A Loyal CEO*, BUS. WK., Feb. 5, 2001, at 30 (reporting on study finding CEO compensation, including stock options, had no significant effect on turnover, unless CEO had large stockholdings).

[252]*See* Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993).

[253]*See* Lyman Johnson, *The Social Responsibility of Corporate Law Professors*, 76 TULANE L. REV. 1483 (2002).

[254]*Id.*

loyalty with more significance than the legal minimum intended by lawyers.[255] The result is a much-needed upgrading of conduct beyond what is required to avoid legal sanction.[256]

V. CONCLUSION

The notion of "due loyalty," as informed both by the lushness of loyalty outside corporate law discourse and the unfortunate curbing of care within that discourse, can help judges and other corporate law participants come to grips with the key question of whether the demands of loyalty should "expand to exact more than the negative act of nonbetrayal to include affirmative attention and devotion."[257] The common thread running through the courtroom, boardroom and classroom settings is the appreciation that a moral vocabulary has been, and should remain, central to corporate law discourse. This is the issue that lies at the heart of corporate governance after Enron. The answer we give will shape the terms of corporate discourse in the years ahead.

Breach of care as a discrete legal theory for obtaining money damages may be gone, but the concept of care is too foundational to expel altogether from corporate law, as the inescapable overlap of loyalty and care reveals. From a legal sanctions standpoint, the duty of "loyalty" remains robust. The historical, social-moral, and literary richness of that term is capacious enough to encompass (and so preserve for corporate law) a good portion of care. Yet, section 102(b)(7) and similar statutes unmistakably sought to curb care claims. That effort could turn out to be quite modest given that Delaware corporate law has aligned the fiduciary duty of care with only one dimension of the multi-dimensional norm of care. In short, care has been rendered a "small" notion in corporate law. It largely refers to the *manner* in which directors are to act. It is a process-oriented duty to act "with care."[258] Having confined care to that narrow chamber, the other meanings of care as found in the phrases "take care of" (the corporation) and "care for" (the corporation) remain fully available for infusion into corporate law through an expansive duty of loyalty.

On the scholarship front, much of mainstream corporate law scholarship over the last twenty-five years has been (or was thought to be)

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[255] *See* Lyman Johnson, *Reclaiming an Ethic of Corporate Responsibility*, 70 GEO. WASH. L. REV. 957 (2002).

[256] *Id.*

[257] FLETCHER, *supra* note 51, at 40.

[258] *See* Johnson, *supra* note 5, at 810; Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is *process* due care only.").

anormative due to the pervasive influence of law and economics. Corporate law scholarship, however, has recently rediscovered social norms.[259] Many disciplinary perspectives can enrich our understanding of this relationship between social norms and (corporate) law.[260] It would be a mistake, however, in this renewed theoretical focus on the inter-relationship between law and social norms to so decontextualize the inquiry that we overlook the enormous potential of corporate law's already-existing and overtly norm-laden vocabulary of "care" and "loyalty." These historic legal notions are grounded in the larger social-moral norms whose very inter-relationship with law is being examined in scholarship. These terms provide a doctrinal entry point for scholarly insights and afford linguistic access for the judiciary and bar to join scholars in the project of expressing and reinforcing social norms through corporate law and practices. The point here is that we stand at the beginning, not the end, of this important, self-reflective episode in corporate law. After Enron, the duties and norms of corporate law and corporate culture should be regrounded in widely shared social norms. To do this, we must first reflect on and remember the vitality and necessity of loyalty discourse in corporate law.

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[259] *See supra* notes 7, 192.

[260] Robert Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603, 1647 (2000). *See* Lynch v. Vickers Energy Corp., 383 A.2d 278, 281 (Del. 1977) (referring to "both the norm and the mandate" of corporate disclosure).