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Natural Law and the Fiduciary Duties of Business Managers*

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Recent business scandals have focused attention on failures of corporate governance involving serious breaches of traditional legal and ethical standards on the part of those who manage corporate affairs. This article argues that the legal standards applicable to managerial behavior are traceable to deeply rooted moral standards that are the basis of the "fiduciary principle"; that the fiduciary principle is a principle of natural law that has been incorporated into the Anglo-American legal tradition; and that this principle underlies the duties of good faith, loyalty, and care that apply to corporate directors and officers. The fiduciary duties of corporate managers run to shareholders and not to creditors, employees, and other "stakeholders." This article further argues that corporate directors cannot eliminate their fiduciary obligation by contract. Enforcement by the courts of longstanding fiduciary standards of conduct is a better solution to problems of corporate governance than increased government regulation.

> *… the laws of commerce … are the laws of nature, and consequently the laws of God.*
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> —Edmund Burke (1795)

Introduction

The news media in recent years have been filled with stories of business scandals involving massive failures of corporate governance. These failures reflect widespread deviation from traditional ethical and legal standards on the part of the directors and officers who manage corporate affairs. Investigations of the derelictions underlying recent corporate disasters have uncovered startling examples of fraud, self-dealing, and neglect.

These episodes have raised once again two fundamental questions: To what standards should managers be held? What are the historical and conceptual bases for these standards? In this article, I hope to show that the legal standards applicable to managerial behavior are traceable to deeply rooted moral standards, and that these fundamental moral standards are the basis of the fiduciary principle that underlies the duties of corporate managers. Further, I will argue that the fiduciary principle is a principle of natural law that has been incorporated into Anglo-American law through the common law tradition. I conclude that it is only by vigorous adherence to this tradition that abuses of trust can be prevented.

The Nature of Fiduciary Duty

Professor Austin Scott, who for many years was the leading American scholar in the field of trust law, wrote in 1949 an important article showing that the fiduciary principle extended far beyond the law of trusts to include many relationships including the duties of agent to principal, attorney to client, guardian to ward, and executor to legatee. As we will see, the fiduciary principle also includes duties of corporate managers to the corporation and its shareholders. Scott defined the term *fiduciary* to mean "a person who undertakes to act in the interest of another person."[1] In most fiduciary relationships, the fiduciary is given control over some aspect of the life or property of another (the beneficiary) with the expectation that the fiduciary will exercise that control for the benefit of the beneficiary. The salient elements of a fiduciary relationship are "the actual placing of trust and confidence in fact by one party in another and a great disparity of position and influence between the parties to the action."[2]

Underlying the fiduciary relationship is the element of trust, which is a necessary condition of social harmony and of the proper functioning of organizations. Indeed, trust can be regarded as a "precontractual" element in all social arrangements. In fiduciary relationships, because of the fiduciary's position of dominance and control over some aspect of the life or property of the beneficiary, the latter must necessarily trust the fiduciary to give proper consideration to the beneficiary's interest. The fiduciary relationship thus gives rise to an ethical obligation of loyalty on the part of the fiduciary. This aspect of the moral law is regularly enforced by courts of equity.

Natural Law and the Fiduciary Duties of Business Managers

The fiduciary principle is of great antiquity. It is clearly reflected in the provisions of the code of Hammurabi (c. 1700 B.C.) that set forth the rules governing the behavior of agents entrusted with property. Virtually every source of primitive law deals with the entrusting of property for safekeeping, pledges of good faith, and other indicia of trust.[3] In the Judeo-Christian tradition, the religious roots of the fiduciary principle can be traced to the Old and New Testaments. In the Old Testament, the Lord told Moses that it is a sin not to restore that which is delivered unto a man to keep safely, and penalties must be paid for the violation (Lev. 6:2–5). Other examples include the fraudulent betrayal by Jacob of Isaac's trust to obtain his father's blessing (Gen. 27), the requirement to redeem pledges (Ex. 22:26), and prohibitions against unjust weights (Deut. 25:13–16). The New Testament contains a particularly clear example of the fiduciary principle in the parable of the unjust steward (Luke 16:1–8). An employer had accused his steward of wasting his goods and threatened to fire him. Knowing that he might soon be looking for a job, the steward decided to advance his own interest by agreeing with his employer's debtors (some of whom might later employ the steward) to release them from their obligations to the employer upon payment of a fraction of what they owed. The steward, who was entrusted with the management of his master's property, thus violated a fiduciary duty by serving his own interest rather than that of his master. Saint Luke states the underlying principle clearly: "No servant can serve two masters" (Luke 16:13). (See also Matthew 6:24, "No man can serve two masters.") This principle is particularly appropriate, of course, when one of the masters is oneself. It has often been said by the courts that the fiduciary duty of loyalty is based upon the biblical precept that no person can serve two masters.[4]

The ethical norms arising from relationships of trust and confidence are not limited to Western societies. Chinese history, for example, reflects a similar fiduciary principle. One of the three basic questions of self-examination attributed to Confucius is the following: "In acting on behalf of others, have I always been loyal to their interests?"[5] The Chinese concept of "Tao" was in some respects similar to the Western concept of natural law in that it reflected a natural order that served as a basis for law and as "a moral link between enacted law and transcendent principles."[6] Chinese rulers were deemed to have "a fiduciary responsibility to maintain harmony between the human and natural worlds."[7] The fiduciary principle was recognized in the codification of Chinese law under the Qing Dynasty (1644–1911),[8] and is recognized in modern Chinese law.[9]

Roman jurists incorporated the ethical obligations of the fiduciary principle into law, most notably in *mandatum* (the relationship of commission or agency), which involved an undertaking by the mandatory (agent) to act for the benefit of the mandator (principal). Cicero pointed out the link between the ethical inequity of breach of trust and the legal consequences:

> In private business, if a man showed even the slightest carelessness in his execution of trust [*mandatum*]—I say nothing about culpable mismanagement for his own interest or profit—our ancestors considered that he had behaved very dishonorably indeed. In such cases a trial for breach of trust was held, and conviction on such a charge was believed to be every bit as shameful as conviction for an offense such as theft.[10]

Anyone who betrays such a trust, Cicero added, "is undermining the entire basis of our social system."[11]

Feudal relationships in medieval Europe were based on mutual trust and loyalty. The fiduciary principle was integral to the feudal law. Indeed, the very essence of the basic feudal contract was "faith" or "fealty" (*fidelitas*). The modern trust has its origin in the medieval English device of the "use," under which a feoffor gave legal title to property to a "feoffee to uses," for the benefit of the feoffor or a third party (the "*cestui que* use").[12]

As the medieval use developed into the modern law of trusts, the ancient rule encompassed in the fiduciary principle that no man can serve two masters was enforced by courts of equity in England and later in the United States. In the leading case of *Keech v. Sandford*,[13] the trustee held a profitable lease in trust for an infant beneficiary. On renewal of the lease, the lessor refused to renew without a covenant that the infant could not enter into, so the trustee took the renewal for himself. The court held that this was a breach of trust. The rule in *Keech v. Sandford* is not confined to trustees. "Whenever a person clothed with a fiduciary or quasi fiduciary character or position gains some personal advantage by availing himself of such character or position, a constructive trust is raised by courts of equity, such person becomes a constructive trustee, and the advantage gained must be held by him for the benefit of his *cestui que* trust."[14]

The English law of fiduciary obligation was carried forward into American law. A leading American case is *Michoud v. Girod*, which involved a purchase by an executor of property from the estate. The Supreme Court held that the purchase would be set aside at the instance of the beneficiary. The Court suggested that "[t]he general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. It restrains all agents, public and private.…"[15]

Although nineteenth- and early twentieth-century jurisprudence reflected a trend toward positivism and away from moralistic concepts of law, the moral element in law has always been present. Dean Roscoe Pound observed:

> In fact, the ethical element in application of law was never excluded from the actual administration of justice.… A great and increasing part of the administration of justice is achieved through legal standards. These standards begin to come into the law in the state of infusion of morals through theories of natural law. They have to do with conduct and have a large moral element. The standard of due care in the law of negligence, the standard of fair competition, the standard of fair conduct of a fiduciary, the Roman standard of what good faith demands in a particular transaction, … all involve an idea of fairness or reasonableness.[16]

With respect to fiduciary relations, he cited Joseph Story's treatise on equity jurisprudence for the proposition that courts enforce the fiduciary duty of good faith "in aid of general morals."[17]

The best-known modern decision embodying the fiduciary principle is Judge Cardozo's opinion in *Meinhard v. Salmon*.[18] In this case, defendant Salmon held a twenty-year lease on a hotel in New York City. Salmon entered into a joint venture with Meinhard, the plaintiff, to renovate the building. Salmon was to have sole power to "manage, lease, underlet, and operate" the hotel. When the lease was about to expire, Salmon negotiated with the lessor, who also owned some adjacent property, and obtained in his own name a new long-term lease on the entire tract. Salmon never informed Meinhard of these negotiations. Meinhard bought suit asking that the new lease be held in trust as an asset of the joint venture. The court concluded that Salmon held the old lease as a fiduciary, and therefore Meinhard had a right to share in the "pre-emptive opportunity" presented by the new lease. Judge Cardozo's opinion contains a paragraph that has been quoted an infinite number of times by lawyers and judges in cases involving fiduciaries:

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising

> rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[19]

The facts of *Meinhard v. Salmon* reflect the basic elements of a fiduciary relationship: Meinhard was a woolen merchant who had entrusted his money to Salmon, a real estate operator, and Salmon was in control of the business with exclusive powers of management. Thus, as Judge Cardozo analyzed the case, Meinhard's dependency on Salmon was clear. The relationship imposed upon Salmon a duty of loyalty that went beyond the strict terms of the contract. It is principally the vulnerability of the beneficiary (in this case the passive partner) to the abuse of power by the manager that gives rise to the need for fiduciary rules of conduct. The result in *Meinhard v. Salmon* can be criticized on the ground that Meinhard was not a "vulnerable" plaintiff but rather an experienced businessman who voluntarily ceded control over the operation of the venture to Salmon. Meinhard could have protected himself in the partnership agreement but failed to do so. Nevertheless, Judge Cardozo's opinion shows the extent to which courts will protect passive associates from overreaching by managers. This tendency reflects the basic principles of fiduciary conduct that, as I will argue below, are derived from the natural or moral law. Meinhard, moreover, illustrates a crucial point in the relationship between law and economics. Without the protection of fiduciary duties, passive investors will be reluctant to invest in risky projects. Adherence to high fiduciary standards is therefore essential to the success of our system of managerial capitalism.

The Fiduciary Obligation as a Principle of Natural Law

The foregoing recitation of the history of fiduciary obligation demonstrates that fiduciary responsibility stems from fundamental moral principles of trust that are inherent in certain human relationships. As we have seen, many human societies have recognized the fiduciary principle. As Timothy Fort and James Noone conclude, "If many cultures repeatedly articulate the same norm, that norm is evidence of a 'natural law' that all persons must take into account in making moral judgments. For example, the fact that all world religions, as well as higher primates, have a social rule of reciprocity indicates that this norm may be stitched into our moral nature."[20]

The literature on natural law is so vast that it is impossible to do more than give a brief and inadequate summary in this article.[21] Further, any attempted definition of *natural law* is bound to be arbitrary. As a working start, however, I will define natural law as a system of principles for the guidance of human conduct, derived from the nature of man as a free, rational, and social being, and ascertainable independently of specific positive law as enacted in any given polity. In the history of jurisprudence, natural-law theory is generally contrasted with "legal positivism," which asserts that law is merely the will of the sovereign and has no intrinsic connection to any moral order. In today's world, the will of the sovereign means the power of the state. It was obvious to Saint Thomas Aquinas, on the other hand, that law is more than the will of the sovereign: "In order that the volition of what is commanded may have the nature of law, it needs to be in accord with some rule of reason, … otherwise the sovereign's will would savor of lawlessness rather than law."[22] The abandonment of this fundamental insight by modern positivist and pragmatic legal theories has invited the very lawlessness that Aquinas warned against. The difference between these two views of law is critical: If there is no natural or higher law, then there is no conceptual basis for arguing that any human law is unjust.

Under natural-law theory, humans are by nature social beings with a capacity for cooperation through the development of moral rules to constrain individual behavior. Because man is both a rational and a social being, he is able to think about the basis of his mutual relationships with others and to derive through the use of his reason the principles of human association in the *polis*.[23] The application of reason to human conduct is the essence of the rule of law. Given the rational and social nature of man, practical reason shows that we need certain norms ("oughts") to live together as humans. As Aristotle noted, "He who bids the law rule may be deemed to bid God and Reason alone rule, but he who bids man rule adds an element of the beast.… The law is reason unaffected by desire."[24] The Stoic philosophers constructed from these principles a universal system based on the concept that all men have received from nature the gift of reason, and law is right reason as applied to the regulation of human behavior. Perhaps the most famous formulation of the Stoic concept of natural law is in Cicero's *Republic*:

> True law is right reason in agreement with nature; it is of universal application, unchanging and everlasting; it summons to duty by its commands, and averts from wrongdoing by its prohibitions.... We cannot be freed of its obligations by senate or people, and we need not look outside ourselves for an expounder or interpreter of it. And there will not be different laws at Rome or Athens, or different laws now and in the future, but one eternal and unchangeable law will be valid for all nations and all times, and there will be one master and ruler, that is, God, over us all, for he is the author of this law, its promulgator, and its enforcing judge.[25]

The concept of nature in natural-law theory does not refer to materialistic biology but "to the rational nature of each individual man [and] to man's endowments of intellect and free will, on which rest the dignity, liberty, and initiative of the individual person; …"[26] For man, as a free, rational, and social creature, the order of being becomes an "order of oughtness, a moral order, …" because the light of reason, inherent in our nature, if properly followed, tells us what rational and free creatures ought to do and avoid.[27] The natural law is prescriptive and not merely descriptive. The Latin word *naturalis* suggests a necessary condition or presupposition of social order. The function of justice is to establish and preserve a fair, predictable, and stable order of human relationships. The human social order depends upon the recognition of basic principles of possession, reciprocity, and obligation. From these requirements can be derived a number of general principles that form the basis for contractual and other obligations. "Thus there is a *naturalis possession* at the root of all property. There is a *naturalis obligation*, which may or may not be legally protected, but which is the necessary prerequisite of all obligations."[28]

In the centuries following Cicero, the Roman jurists formulated a system of jurisprudence that, in its essential characteristics, adhered to the Stoic premise that law should correspond to natural and universal justice. The *Institutes of Justinian*, published in the sixth century A.D., restated the basic principles of natural justice: "The precepts of law are these: to live honestly, not to injure anyone, and to render to each person what is due."[29] From the precepts of natural justice, it follows that injuries are to be rectified, promises fulfilled, stolen property restored, and quarrels adjudicated. The fiduciary principle is also derived from the principles of natural justice. All stable and collaborative social institutions require trust and loyalty among the members. The "institutionalization of trust" is therefore essential to life in society and to associations, corporations, and other groups within society. The institutionalization of trust requires, *inter alia*, that lives and property entrusted to another be faithfully respected. This is the essence of the fiduciary principle. The fiduciary principle also follows from Justinian's formulation of natural-law precepts obliging us to act honestly and to give to each his due. For example, if property has been entrusted to us, we must secure it from harm and, if it is lost through our faithlessness, we must restore its value together with any improper gain that we may have received from the use of it.[30] These rules of natural justice apply to those who manage a private enterprise or association, as well as to public officials. As indicated by Aristotle's reference to "God and Reason" and the passage from Cicero's *Republic*, quoted above, classical concepts of natural law are closely connected to religion. During the Middle Ages, Christian thinkers developed a theory of natural law that was based on divine law. As Saint Thomas Aquinas expressed it, "This participation of the eternal law in the rational creature is called the natural law."[31] In short, natural law in the Western tradition assumed that moral obligation was inherent in human nature as part of the divine order. Even modern interpretations of natural law that are not specifically theist in origin assume that there is a higher law whose principles are superior to those of positive law.[32]

The specific content of natural law has, of course, been much debated over the centuries. Under virtually any interpretation, however, it is sufficiently broad to include the fiduciary principle. Aquinas specifies a number of precepts of practical reason, which can be derived from the nature of man as a rational and sociable being and the requirements of a rational social order. Most basic of these is the preservation of human life. Other precepts of practical reason include the ownership of property and the prohibition of theft and fraud. Aquinas also includes an important aspect of the fiduciary principle: "Goods entrusted to another should be restored to their owner."[33] This can be seen as the application of trust (*fides* or good faith) to the institution of property.

Hugo Grotius, the noted seventeenth-century-natural-law theorist, derived natural law from the nature of man as a rational being and man's need to maintain social order.[34] The maintenance of social order requires adherence to certain basic principles: abstaining from what is another's, the obligation to fulfill promises, and the making good of a loss incurred through our fault (the bases, respectively, of property, contract, and tort). Another principle is "the restoration to another of anything of his which we may have, together with any gain which we have received from it; …"[35] This principle, together with that of *fides* (good faith) that underlies it, is at the heart of fiduciary obligation.

Underlying natural-law theory is a universally felt need to justify statutes and legal decisions, and this process of justification requires principles of right and wrong. Legal positivists have long argued that there is a sharp conceptual separation between morals and law, but natural law, history, and common sense dispute this conclusion. While it is true that not all moral principles are reflected in positive law, it is also true that many moral principles *are* embodied in law. Some obvious examples are duty of parents to children, obedience of children to parents, the duty not to kill an innocent person, truthful speech, fidelity to one's given word, respect for the dignity of others, and the obligation of loyalty to one who has reposed trust and confidence (this last point being particularly relevant to the subject under discussion here). Of course, the basic norms that constitute natural justice are quite general. In practice, more specific rules can be obtained only by a consideration of various circumstances. The variety of possible circumstances explains the diversity of positive laws. In spite of the apparent victory of positivism over natural-law jurisprudence in the first half of the twentieth century, lawyers and judges, as Roscoe Pound showed, have continued to rely on norms such as good faith, restitution, and other equitable doctrines of the higher law. Under all natural-law theories, law is conceived as an objective basis of rights and duties, originating not in the arbitrary will of the sovereign but from a natural order reflecting the essential dignity and freedom of human beings. As the American Declaration of Independence states, the "laws of Nature and of Nature's God" establish certain self-evident truths about the rights of man. Indeed, natural-law theories always tend to reemerge precisely when freedom is threatened. When the positive legal order becomes unjust, men return to the self-evident truths of the moral law, which place limits on arbitrary government.[36]

The Fiduciary Principle and the Duties of Business Managers

The fiduciary standards of good faith and honest dealing apply to business as well as to personal relationships. This was the case in Roman law and continues to be true today.[37] As Edmund Burke said, "The laws of commerce … are the laws of nature and consequently the laws of God."[38]

As in the case of other social institutions, the law imposes obligations upon those who manage business enterprises that are designed to ensure that the managers have regard for the interest of the members who have entrusted their assets to the venture. (The term *managers*, as used here, includes both directors and officers of corporations.) These obligations are reflected in concepts applied by the courts, such as loyalty, due care, good faith, and fairness. What we now call "corporate governance" is the application of the duties associated with these concepts to the management of corporations. As discussed above, these concepts are derived from natural-law principles and are a part of the "institutionalization of trust" that is essential to the survival of all human associations.

American courts have long held that corporate directors are fiduciaries.[39] The relationship is a fiduciary one because the shareholders have given control over the corporation's assets to the directors with the expectation that the directors will exercise that control for the shareholders' benefit. The United States Supreme Court in *Pepper v. Litton* traced the duty of a corporate manager back to its ancient roots in the natural or moral law:

> He who is in such a fiduciary position cannot serve himself first and his *cestuis* second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters.[40]

The law of Delaware has become the principal source of corporate law in the United States because a majority of large corporations are incorporated in Delaware. Delaware has also established a highly regarded chancery court system with judges having special competence in corporate litigation. Under Delaware law, directors stand in a fiduciary relationship to the corporation and its shareholders. The fiduciary nature of directors' duties has been consistently reaffirmed by the Delaware courts.[41] The courts of other states are in accord.[42]

As in the case of any fiduciary duty, the obligation of a corporate director or officer to the corporation and its shareholders is greater than a mere obligation to perform one's contracts and to avoid injuring others. It involves affirmative duties of good faith, loyalty, care, and disclosure.

Good Faith

The duty of good faith (*bona fides*) requires honesty of intention in dealing with others and avoidance of conduct that is unconscionable or seeks to take undue advantage of the actor's superior knowledge of relevant circumstances to the detriment of another. Good faith is at the heart of all fiduciary duties and is derived from principles of natural law.[43] It is a term traditionally used to designate the mental state of honest conviction as to the truth of a proposition or the morality of an action.[44] In connection with responsibility of a fiduciary, good faith takes into account the fiduciary's intentions as well as the degree of his attention to duty.

A recent decision of the Delaware Chancery Court shows the continuing importance of good faith in performing the duties of corporate directors. A shareholder suit against directors of the Walt Disney Company alleged that the directors breached their fiduciary duty when determining the compensation and terms of termination for the former president of the company. The complaint charged that, after tenure of barely one year, the former president left the company, receiving severance pay and other benefits exceeding $140 million. The facts alleged in the complaint indicated that the directors' approval of the compensation arrangement, which carried with it obvious financial risks to the company, was perfunctory and uninformed. In refusing to dismiss the case, the court said that the alleged conduct of the directors amounted to "deliberate indifference." Such conduct would constitute a failure to act "honestly and in good faith."[45]

The beneficiary in a fiduciary relationship is particularly vulnerable to deception, which is an obvious manifestation of dishonesty. Illustrations of fraudulent conduct are a depressing feature of corporate life. When, for example, the chief financial officer is directed by the chief executive officer to falsify the company's financial statements to conceal its poor financial condition, he should, of course, refuse to do so because his primary duty is to the company and its shareholders, who deserve to be told the truth, not to the CEO. Ignoring this simple rule has led to a great deal of mischief and personal tragedy.

Duty of Loyalty

The duty of loyalty is simply a restatement of the basic moral principle that a person who undertakes to act for another must refrain from placing his own interest ahead of the other's interest. In the corporate context, it requires that the directors devote "an undivided and unselfish loyalty to the corporation," and that "there shall be no conflict between duty and self-interest."[46]

The loyalty rule that was generally applied to corporate fiduciaries by American courts in the nineteenth century followed the strict doctrine of trust law that any transaction between a trustee and the trust is automatically voidable at the behest of a beneficiary, whether or not the terms were fair.[47] As modern corporate capitalism developed, it became evident that a rule making every contract between the corporation and a director or his affiliate automatically voidable at the instance of the corporation was impracticable. Faced with the reality that corporations often needed to do business with directors or their affiliates, state legislatures adopted "safe harbor" statutes providing that a contract or other transaction between a director and his corporation, or between corporations with interlocking directors, is not voidable simply because there is a fiduciary relationship between the parties if there is disinterested approval or if the interested person can prove that the transaction is fair to the corporation.[48] The duty of loyalty has by no means been abandoned. It has merely been modified to take into account the needs of a dynamic economy in which business people with many interests must deal with each other. The fiduciary principle remains applicable because the action taken by the directors must be taken in good faith and conform to the fiduciary standards of loyalty, due care, and candor.

Duty of Care

The virtue of prudence has deep roots in the moral law. From classical to early modern times, it was considered to be one of the cardinal virtues, along with justice, courage, and temperance, and was often identified with practical reason. Prudence involves the qualities of foresight, deliberation, and judgment that are needed for clear-sighted, objective decisions.[49] In law, the standard of reasonableness or prudence has been adopted by Anglo-American courts to bring an element of objectivity into decision-making in matters involving alleged negligence or nonfeasance.

The duty of prudence, or "duty of care" as it is usually called today, is often cited in fiduciary-law sources as an intrinsic aspect of relationships of trust and agency. The duty of care can be viewed as a corollary of the duty of loyalty because loyalty demands that the fiduciary bring a disinterested focus to his responsibilities and exercise prudence in carrying out his trust. In its classic formulation in corporate law, the duty of care provides that "[a] corporate director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances."[50] This standard is commonly referred to as the "prudent man" rule. It has long been recognized, however, that there are numerous risks inherent in the decisions that directors and officers are required to make and that these decisions should not be subjected to second-guessing by courts merely because the decisions turn out in hindsight to have been unwise or unsuccessful. Accordingly, courts have developed the "business-judgment rule," under which a director or officer who makes a business judgment will be held to have fulfilled the duty of care if he or she acted in good faith, was disinterested, was reasonably informed, and rationally believed that the action taken was in the best interests of the corporation.[51] The courts have been careful to impose limits on the business judgment rule. Directors will not be permitted to take advantage of the rule, for example, if they were not sufficiently disinterested[52] or if they were not adequately informed.[53] In addition, the business judgment rule does not apply to the failure of the directors to exercise proper oversight over the corporation's business.[54]

A faithful fiduciary, in short, must be informed and must act rationally in order to fulfill his trust. The requirement of the business judgment rule that directors must be adequately informed is consistent with the doctrine of classical Greek philosophy that no one can act properly without sufficient knowledge—a fundamental axiom of prudence or right reason that is implicit in the Aristotelian-Ciceronian concept of natural law.

Duty of Disclosure

Courts have recognized that directors and officers of corporations have a fiduciary duty to disclose material information when they seek shareholder action.[55] Whether there is a request for shareholder action, moreover, directors who knowingly disseminate false information that results in corporate injury or damage to stockholders violate their fiduciary duty and may be held accountable.[56] The analytical basis for the duty of disclosure (or "duty of candor" as it is sometimes called) is the principle that, in communicating with the shareholders, the directors have the same fiduciary duty to exercise due care, good faith, and loyalty as in other corporate transactions. In short, "the *sine qua non* of directors' fiduciary duty to shareholders is honesty."[57]

As is well known, corporate managers also have duties of disclosure under the federal securities laws. Rules of fiduciary obligation are important in determining whether federal disclosure obligations exist in certain circumstances, for example, where "insider trading" is involved.[58]

Statutory Modification of the Duty of Care

In recent years, many states have adopted legislation permitting shareholders to adopt a provision in the corporate charter designed to eliminate or limit the personal liability of directors for money damages for breaches of the duty of care. These statutes represent a significant limitation on the traditional duty of care. They were deemed necessary by state legislatures because of the extraordinary rise in the frequency and severity of litigation in the United States by shareholders against corporate directors, seeking to hold them responsible for negligent mismanagement even though they did not participate directly in the wrongdoing. The legislators feared that the potential liabilities were so serious that many capable people would be reluctant to serve as directors.[59] The limitation of liability statutes, however, generally do not apply to corporate officers who are the day-to-day managers of the corporate business, and, more significantly, they contain specific exceptions for conduct graver than negligence such as breach of the duty of loyalty or acts involving bad faith, fraud, or other intentional misconduct. Accordingly, notwithstanding the limitation of liability statutes, the most important features of the fiduciary duties of business managers remain applicable and are regularly enforced by the courts.

The Fiduciary Principle Is Not Explainable in Contractarian Terms

Some "law and economics" scholars have argued that fiduciary duties are contractarian and may be modified or eliminated by contract even in the absence of a statute,[60] but this position is analytically and historically unsound. While it is true that many aspects of the trust relationship can be varied by agreement, the basic fiduciary duties of good faith and loyalty cannot.[61] Indeed, as Deborah DeMott has written, "Fiduciary obligation sometimes operates precisely in opposition to intention as manifest in express agreements."[62] In corporate law, while there is a narrow exculpation provided by the statutory provisions permitting limitation of liability for the duty of care, the fiduciary duties of good faith and loyalty cannot be eliminated by contract. The reason is that these fundamental legal duties are not contractual: They have a moral origin and a moral function. There is a natural justice "that is binding on all men, even on those who have no association or covenant with each other."[63] Many social roles carry with them obligations that are noncontractual and are part of the social structure, not objects of negotiation. These include the role of a fiduciary. Someone may agree or not agree to become a fiduciary, but once he has entered into the role, he is not free to abandon the essential norms that attach to it. Contract law itself is dependent on principles of honesty, good faith, and fair dealing, which are rooted in natural law. The basic reason why contract and fiduciary rules are treated differently is that each party to a freely negotiated contract is expected to act in his own interest (subject, of course, to implied obligations of good faith and fair dealing), whereas the beneficiary in a fiduciary relationship is dependent on the fiduciary and is unable to monitor effectively the fiduciary's self-interested behavior. The contractarian position is based ultimately on principles of wealth maximization and economic efficiency, but the rules of fiduciary conduct (like many other rules of human behavior) are based on moral principle, not economic efficiency. Courts have generally understood that, as a Delaware case recently expressed it, "*homo sapiens* is not merely *homo economicus*."[64] Consequently, most judges do not see themselves as maximizers of wealth, but rather as "engaged in a process of trying to understand and protect the values embodied in the law."[65]

The foregoing analysis applies to corporate directors and officers as well as to other fiduciaries.[66] The prohibition against managers' contracting away their fiduciary duties would be a sensible conclusion even if the contractarian position were accepted because an *ex ante* waiver of the duty of loyalty by public shareholders would have to be based on informed consent, and there is no way to disclose in advance to the shareholders all of the possible conflicts of interest that could arise.

The corporation is a historical institution that is the product of centuries of social, cultural, and legal as well as economic forces. It is not, any more than a university, a mere "bundle of contracts." The courts did not develop fiduciary rules to reflect the self-interested preferences of economic actors but to implement values of trust and confidence through the application of traditional moral norms. Public shareholders, who cannot effectively bargain with corporate managers, rely on these fiduciary rules when they invest, and fundamental fairness (itself a feature of natural justice) requires that they be observed. The fiduciary principle, of course, applies to closely held business entities as well as to public corporations. See the discussion of *Meinhard v. Salmon* above.

Shareholders and Stakeholders

Corporate managers today face growing pressures from two directions. On the one hand, shareholders demand that managers pay more attention to increasing value for the shareholder. On the other hand, advocates of corporate social responsibility hold that managers have obligations not just to the corporation and its shareholders but to employees, creditors, and other "stakeholders," including the communities in which they operate. Stakeholder proponents argue, for example, that the social responsibilities of managers include environmental protection, sustainable use of natural resources and power-sharing with workers. Most of the countries of continental Europe have a political climate that favors the stakeholder model. This point of view is linked to welfare state policies that emphasize social welfare responsibilities and the need for extensive government regulation of the economy.

During the 1980s, a number of states in the United States adopted statutes, generally referred to as "nonshareholder constituency statutes," that permitted (but did not require) corporate directors to take into account the interests of various stakeholders—such as employees, customers, suppliers, and communities—in making decisions on behalf of the corporation.[67] These statutes were a response to the takeover movement of the 1980s. They were designed to protect local companies from being swallowed up by outside raiders, rather than being a conscious effort to move the law toward a stakeholder paradigm. In any event, the constituency statutes, to date, have not been construed so as to create duties to other constituencies equivalent to fiduciary duties to shareholders.

Proponents of the stakeholder model of corporate governance assert that employees, creditors, suppliers, customers, and communities all make "firm-specific" contributions to the company, so that directors should have responsibilities to all of these constituencies. Under the traditional shareholder-value model, corporations conduct business with a view to enhancing corporate profits and shareholder gain. This is the position taken by a great majority of American cases. This position gives the directors a single channel of fiduciary accountability and a clear focus on increasing the value of the business over time. In economic theory, the shareholder-value model promotes economic efficiency because shareholders, as residual claimants, have the greatest incentive to maximize the profits of the firm and should therefore be the beneficiaries of the bottom-line duties of managers.[68]

If the stakeholder model means that managers have a duty to employees, creditors, and other stakeholders that is equivalent to the duty owed to shareholders, the difficulties of serving multiple masters are obvious. In many situations, the interests of shareholders and stakeholders will conflict. Suppose, for example, that management decides to close a clearly unprofitable plant. Shareholders will benefit from the closure, but some employees and the local community may suffer. Without the guidance provided by the principle that long-term shareholder value comes first, it will be difficult for managers to make a decision. If the interests of all stakeholders must be given equal consideration, the directors will either decide to do nothing or will make a political compromise rather than a business decision. As a practical matter, this means that directors will be able to cite the interests of some constituency as a reason for not acting, thereby serving their own vested interest in preserving their jobs. Simply put, stakeholder theory sounds good in social theory but will not work in practice.

This analysis does not imply, of course, that nonshareholder constituencies have no legal remedies. The corporation has a variety of enforceable legal relationships with employees, creditors, suppliers, and other third parties. In addition, managers are obligated to obey the law and to establish procedures for oversight over the company's compliance with environmental, safety, labor, and other governmental regulations. The managers and the stakeholders are thus tied in an interlocking web of relationships and statutory protections that effectively protect the third parties.

In addition, and more significantly for the purposes of this article, the conclusion that managers in most cases do not have fiduciary duties to stakeholders does not mean that they have no ethical duties to them. Men and women do not cast off their ethical responsibilities by becoming corporate managers. They are morally obligated to treat the company's employees with respect, to avoid jeopardizing the health or safety of customers, and not to deceive the public. These duties follow from elementary natural-law principles, such as do the duties to avoid harming others (*non fit injuria*), to act honestly, and to give to each person his due. Companies whose managers regularly fail to meet these moral obligations will not survive over the long term. Corporate managers, moreover, are constrained not only by their traditional moral duties but by their reputational interest in adhering to accepted standards of conduct. Directors and officers are not eager to be branded as slavedrivers or polluters.

There are limits, however, to the freedom of corporate managers to devote corporate assets to eleemosynary purposes. Shareholders, as the residual risk takers, have entrusted their funds to the corporation for the purpose of gaining profit. This creates a relationship of trust that, in law and in equity, takes precedence over the inclination of managers to be charitable with other people's money. It is entirely justifiable that corporate managers should consider the legitimate interests of employees, customers, suppliers, and other constituencies, including the community, but only so long as there is a rational and perceptible nexus between actions favoring other constituencies and long-term shareholder benefit.

Sensitivity to environmental and social concerns is good business judgment. It would be unfair, however, to demand that business enterprises clean up the world's environmental messes or provide poor relief, elementary education, police protection, and other "public goods" at the expense of their shareholders. These are political problems to be addressed by government under the rule of law, not passed on to corporate managers who have not been elected by and are not accountable to the voters at large. It is for this reason, among others, that managers' fiduciary duties of loyalty and care run to their companies and shareholders, not to the public. To hold otherwise is to create a confusion of roles that can only be harmful both to corporate and to political governance.

Conclusion

This article has summarized the basic fiduciary duties of corporate directors and officers and has argued that these duties have their origin in principles of natural law. Recent corporate governance scandals reflect a widespread failure to adhere to these traditional duties of good faith, loyalty, and care.

The factual record of governance failures is replete with examples of self-dealing and conflict of interest on the part of management, in which directors either participate or acquiesce. These examples invariably evidence a violation of the ancient rule by which an agent is not permitted to prefer his own interest to that of the principal, where the two conflict. The parable of the faithless steward in chapter 16 of Saint Luke's gospel is a paradigm case. The most obvious common feature of recent managerial misdeeds is the financial interest of managers in increasing the value of their stock options and bonuses by manipulation of the corporate earnings through fraudulent accounting techniques. A related example is "insider trading," in which managers use a corporate asset (confidential information about expected events) to make a personal trading profit. Another common abuse is the loan of corporate funds (sometimes amounting to tens of millions of dollars) to top executives for personal use.

A common element in these transgressions has been the failure by boards of directors to exercise their duty of care. This duty, under American law, is not especially rigorous, as seen in the fact that a finding of liability requires grossly negligent behavior or obvious inattention to duty. Yet, in many recent cases of corporate disaster, boards have failed to uncover behavior that even a minimum investigation would have shown to be damaging or illegal and have awarded options, bonuses, and other forms of executive compensation in amounts that would have made Croesus blush. Officers and directors are not the only responsible parties. Outside accountants have sometimes ignored signs of financial fraud, influenced by reluctance to lose opportunities for additional lucrative business from the corporation. Recent administrative settlements have revealed that some major banks have aided and abetted fraudulent corporate activity in order to protect lending or other profitable relationships. All of these recent abuses are violations of basic moral principles and well-established legal duties worked out by legislatures, courts, and commentators over the centuries.

The American system of free-market capitalism has been a powerful engine for the production of wealth, and it would be unwise to impair the effectiveness of this system through unnecessary government regulation. Yet, increased regulation is the inevitable result of massive corporate scandals that capture the attention of voters and their elected representatives. A far-better solution is for shareholders, who are the owners of corporations, to insist that those they hire to manage the business adhere to longstanding fiduciary standards of conduct, based on the traditional moral law and enforced by courts in accordance with regular and established procedures. There are some recent signs that major institutional shareholders (particularly pension funds) are beginning to use their power and influence to guard the corporate guardians and enforce the ancient rules.

Notes

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1. Austin Scott, "The Fiduciary Principle," *CAL. L. REV.* 37 (1949): 539, 540. Scott's definition has been criticized as placing undue emphasis on voluntary assumption of the duty by the fiduciary. This definition does not work in the case of a constructive trustee or in certain other cases in which courts impose fiduciary duties, such as actions by a majority shareholder in a corporation that may affect minority shareholders. See Deborah A. DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation," *DUKE L.J.* (1988): 879, 910–11.

2. Morris v. Resolution Trust Corp., 622 A.2d 708, 712 (Me. 1993). "'[A]t the heart of the fiduciary relationship lies reliance, and de facto control and dominance.'" United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991), *cert. denied*, 503 U.S. 1004 (1992).

3. See Albert Kocourek and John H. Wigmore, *Sources of Ancient and Primitive Law* (1915; repr., Littleton, Colo.: F. B. Rothman and Company, 1979), 404–11, 483–87, 665–71.

4. Pepper v. Litton, 308 U.S. 295, 311 (1939); United States v. Miss. Valley Generating Co., 364 U.S. 520, 549, 550 n. 14 (1961).

5. *The Analects of Confucius*, trans. A. Waley, vol. 4 (London: G. Allen & Unwin, 1938).
6. Karen Turner, "Rule of Law Ideals in Early China?" in *Basic Concepts of Chinese Law*, ed. Tahirih V. Lee (New York: Garland Publishing, 1997), 24. See C. S. Lewis, *The Abolition of Man* (New York: Macmillan, 1955), 56 analogizing the Tao to natural law.
7. Turner, "Rule of Law," 43.
8. *The Great Qing Code*, trans. William C. Jones (New York: Oxford University Press, 1994), 162 (providing for criminal punishment for one who receives deposit of property of another and consumes such property without authority).
9. See *Basic Principles of Civil Law in China*, ed. William C. Jones (Armonk, N.Y.: M. E. Sharpe, Inc., 1989), 317 (recognizing "contracts of entrustment"), and p. 321 (obligation of brokers to act "honestly, justly, in good faith, and not in a way contrary to the notion of fairness.")
10. Cicero, In "Defense of Sextus Roscius of Ameria," in *Cicero: Murder Trials* (New York: Penguin, 1978), 87.
11. Ibid.
12. See R. H. Helmholtz, "The Early Enforcement of Uses," *Colum. L. Rev.*, 79 (1979): 1503.
13. Chancery, 1726, Sel. Cas. Ch. 61, 25 Eng. Rep. 223.
14. Walter G. Hart, "'The Development of the Rule' in Keech v. Sandford," *Law Q. Rev.*, 21 (1905): 258, 259.
15. 45 U.S. 503, 555 (1846). The Court cited examples of the general rule from Roman law as well as from English law. *Ibid.*, 559–60.
16. Roscoe Pound, *The Ideal Element in Law* (1958; repr., Indianapolis: Liberty Fund, 2002), 86.
17. Ibid., 87, fn. 60 (citing 1) Joseph Story, *Commentaries on Equity Jurisprudence* (1835; repr, New York: Arno Press, 1972) § 431, as well as sources in Roman law.
18. 164 N.E. (N.Y. 1928), 545.
19. 164 N.E., 546.
20. Timothy L. Fort and James J. Noone, "Challenges to Corporate Governance: Bundled Contracts, Mediating Institutions, and Corporate Governance: A Naturalist Analysis of Contractual Theories of the Firm," *L. & Contemp. Probs.*, 62 (1999): 163, 198–99 (citations omitted).

21. For recent treatments of the subject of natural law, see J. Budziszewski, *Written on the Heart: The Case for Natural Law* (Downers Grove, Ill.: InterVarsity Press, 1997); Robert P. George, *In Defense of Natural Law* (New York: Oxford University Press, 1999); Russell Hittinger, *The First Grace: Rediscovering the Natural Law in a Post-Christian World* (Wilmington, Del.: ISI Books, 2003); Alasdair MacIntyre, "Theories of Natural Law in the Culture of Advanced Modernity," in *Common Truths: New Perspectives on Natural Law*, ed. Edward B. McLean (Wilmington, Del.: ISI Books, 2000); Heinrich A. Rommen, *The Natural Law* (1936; repr, Indianapolis: Liberty Fund, 1998).

22. Saint Thomas Aquinas, *Summa Theologica* (New York: Modern Library, 1948), Q. 90, Art. 1.

23. See Aristotle, "Politics," in *The Basic Works of Aristotle* (New York: Random House, 1941), bk. 1:2:1253a; 3:16:1287a; Samuel Pufendorf, *Of the Law of Nature and Nations* (London: Printed for J. Walthoe, R. Wilkin, J. and J. Bonwicke, S. Birt, T. Ward, and T. Osborne, 1717), bk 1, chap. 6, at 76 (natural law is "that which is so exactly fitted to suit with the rational and social nature of men, that human kind cannot maintain an honest and peaceful fellowship without it ; …") The need to counteract the desires of human rulers with the reason of law is the philosophical basis for the separation of powers and the American system of constitutional law. See Edward S. Corwin, *The "Higher Law" Background of American Constitutional Law* (Ithaca: Cornell University Press, 1955), 8–9.

24. Aristotle, *The Basic Works*, 3:16:1287a.

25. Cicero, *Republic*, Loeb Classical Library (New York: William Heinemann, Ltd., 1961), 3, § 22:211.

26. Rommen, *The Natural Law*, at 135.

27. Ibid., 158.

28. Alessandro Passerin D'Entrèves, *Natural Law: An Introduction to Legal Philosophy* (New Brunswick, N.J.: Transaction Publishers, 1994), 33.

29. "*Juris praecepta sunt haec: honeste vivere, alterum non laedere, suum cuique tribuere*." J. Inst., 1.

30. See Hugo Grotius, *The Law of War and Peace* (Indianapolis: Bobbs-Merrill, 1925), 12–13, 25; John Finnis, *Natural Law and Natural Rights* (Oxford: Clarendon Press, 1980), 288 (profits received without justification and at the expense of another must be restored).

31. Saint Thomas Aquinas, *Summa Theologica*, Q. 91, Art. 2. See David Novak, "Law: Religious or Secular?" *Va. L. Rev.*, 86 (2000): 569. Novak argues persuasively that both the classical and the Christian approaches to natural law are based on a divine order that is discovered, not invented, by men. Ibid., 579. If law is to order our

desires in a way that serves the common good, that law cannot be the product of the desires of those who need to be governed by it, but must have a transcendent base. Ibid., 594. See Harold J. Berman, "The Religious Foundations of Western Law," *CATH. U. L. REV.* 24 (1975): 490.

32. Edward S. Corwin, *The "Higher Law"*.

33. Aquinas, *Summa Theologica*, Q. 94, Art. 4. Aquinas makes the point that, because of the complexity of human relationships, when one descends from very general precepts to more specific rules, conditions and exceptions multiply. For example, there might be an exception to the precept of fiduciary obligation if the owner were to reclaim weapons for the purpose of fighting against his own country. This is a classic example of conflict of obligations requiring practical reasonableness (itself a principle of natural law) in accordance with experience.

34. Grotius, *The Law of War and Peace*, 11–14. Grotius also held, however, that natural law was consistent with divine law.

35. Ibid., 13. See also, Samuel Pufendorf, *Of the Law of Nature and Nations*, 3:9.

36. See Russell Hittinger, "Introduction," in Rommen, *The Natural Law*, xii. See also Horace, *Dictum*, Epis. 1:x:24 ("Naturam expelles furca, tamen usque recurret.") (You may expel nature with a pitchfork, yet she will always return).

37. See Cicero, *De officiis*, 3:xvii (obligation to act honestly and in good faith derives from nature and applies to buying, selling, and other commercial relationships).

38. Edmund Burke, "Thoughts and Details on Scarcity," in *Works*, vol. 2, (1795; repr., Boston: C. C. Little & J. Brown, 1839), 180.

39. See Pepper v. Litton, 308 U.S. 295 (1939); Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588–89 (1875). ("That a director of a joint-stock corporation occupies one of those fiduciary relations where his dealing with the subject matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others.")

40. Pepper v. Litton, 308 U.S., 311.

41. See, for example, Guth v. Loft, Inc., 5 A.2d 503,510 (Del. 1939); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Paramount Communications v. QVC Network, 637 A.2d 34, 43 (Del. 1993).

42. See, for example, Francis v. United Jersey Bank, 432 A.2d 814, 824 (N.J. 1981); Alpert v. 28 William St. Corp., 473 N.E.2d 19, 25-26 (N.Y. 1984).

43. Rommen, *The Natural Law*, 24.

44. See *The Catholic Encyclopedia*, www.newadvent.org/cathen/066412a.htm.

45. In re The Walt Disney Company Derivative Litigation, 825 A.2d 275, 289 (Del. Ch. 2003).

46. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

47. Twin-Lick Oil, 91 U.S. 588. See also Harold Marsh Jr., *Are Directors Trustees? Bus. L.* 35 (1966): 22 and cases cited therein.

48. A typical "safe harbor" statute is § 144 of the Delaware General Corporation Law. See also Model Business Corp. Act §§ 8.60-8.63 (1984 & 1994); A. L. I., *Principles of Corporate Governance: Analysis and Recommendations* § 5.02 and Reporter's Note (1994) (hereinafter "A. L. I. Principles"). The safe harbor statutes are often unclear and their precise legal consequences have been much disputed.

49. See Josef Pieper, *The Four Cardinal Virtues*, trans. Richard and Clara Winston (New York: Harcourt, Brace & World, 1965), 12–17; and Douglas J. Den Uyl, *The Virtue of Prudence* (New York: Peter Lang, 1991).

50. A.L.I. Principles § 4.01(a). See Briggs v. Spaulding, 141 U.S. 132, 152 (1891).

51. See *Corporate Director's Guidebook*, 2d ed. (Chicago: Committee on Corporate Laws, Section of Business Law, American Bar Association, 1994), 11; A.L.I. Principles § 4.01(c). The business judgment rule is often stated as a "presumption" that directors and officers have acted properly, which the plaintiff must rebut by showing that one or more of the elements of the rule are not present (e.g., that they were not disinterested or were not adequately informed). See Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

52. See Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980); Lewis v. S. L. & E., Inc., 629 F.2d 764, 769 (2d Cir. 1980).

53. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

54. See In re Caremark Int'l Inc., 698 A.2d 959 (Del. Ch. 1996); A.L.I. Principles § 4.01(c) and cmt. c at 174–75.

55. Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992); Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1276 (Del. 1994).

56. Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

57. Ibid., 10. See Eric A. Chiappinelli, "The Moral Basis of State Corporate Law Disclosure," *CATH. U. L. REV.* 49 (2000): 697.

58. The breach of a fiduciary relationship may give rise to a "misappropriation" of confidential information for purposes of establishing liability under § 10(b) of the Securities Exchange Act of 1934. See United States v. O'Hagan, 521 U.S. 642 (1997). For a comprehensive analysis of the "misappropriation" theory, see

Stephen M. Bainbridge, "Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud," *SMU L. REV.* 52 (1999): 1589.

59. James J. Hanks Jr., "Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification," *BUS. L.* 43 (1988): 1207.

60. John H. Langbein, "The Contractarian Basis of the Law of Trusts," *YALE L.J.* 105 (1995): 625; Frank Easterbrook and Daniel R. Fischel, "Contract and Fiduciary Duty," *J.L. & Econ.* 36 (1993): 425, 427 (arguing that fiduciary relationships "have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual relationships."

61. Restatement (Second) of Contracts §193 (1981): "A promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on grounds of public policy;" Restatement (Second) of Trusts §222(2)(1959) (exculpation clause not effective to relieve trustee of liability for breach of trust committed in bad faith or with reckless indifference to interest of beneficiary). There are many decided cases to the same effect. See Scott, "The Fiduciary Principle," 542. It is noteworthy that the remedies for breach of fiduciary duty are generally equitable, not contractual.

62. Deborah A. DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation," *DUKE L.J.* (1988): 879, 887; Victor Brudney, "Contract and Fiduciary Duty in Corporate Law," *Corporate Practice Commentator* 39 (1998): 749, 760.

63. Aristotle, *Rhetoric*, 1:13:1373 b.

64. In re Oracle Corp. Derivative Litigation, 824 A.2d 917, 938 (Del Ch. 2003).

65. Raymond A. Belliotti, *Justifying Law: The Debate over Foundations, Goals, and Methods* (Philadelphia: Temple University Press, 1992), 126.

66. Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 51 (Del. 1993) ("The Paramount directors could not contract away their fiduciary obligations.")

67. See Morey McDaniel, "Stockholders and Stakeholders," *STETSON L. REV.* 21 (1991): 121; Mark E. Van der Weide, "Against Fiduciary Duties to Corporate Stakeholders," *DEL. J. CORP. L.* 21 (1996): 27.

68. The literature on this subject is extensive. On the stakeholder side, see Margaret M. Blair and Lynn A. Stout, "A Team Production Theory of Corporate Law," *VA. L. REV.* 85 (1999): 247. On the shareholder value side, see Mark E. Van Der Weide, "Against Fiduciary Duties to Corporate Stakeholders." For a British view favoring shareholder value, see Company Law Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework* (London: Department of Trade and Industry, 1999), 44; and Elaine Sternberg, *Corporate Governance in the Marketplace*, 2d ed. (London: Institute of Economic Affairs, 2004).