

CORPORATE GOVERNANCE AND FIDUCIARY OBLIGATION: DO THE TWO COINCIDE IN THE POST-ENRON ENVIRONMENT?

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I. Introduction

The corporate scandals of the past few years have attracted the attention of regulators¹ and practicing attorneys,² of Wall Street³ and Main Street,⁴ and of the business press⁵ and the tabloid press.⁶ Perhaps no group, however, has been more affected than corporate officers and directors. Potential directors are now screening directorship “opportunities” much more closely than in the past.⁷ Director and Officer (D&O) insurance rates have soared.⁸ The quantity of briefing materials provided to directors in association with board meetings has expanded significantly.⁹

One of the most challenging sets of issues, for the courts as well as for directors and officers in ongoing enterprises, is to define the obligations and liabilities of those high level corporate actors who oversee incentive, savings, and pension plans that utilize employer stock as an investment vehicle. Private plaintiffs¹⁰ and the Department of Labor (DOL)¹¹ have filed lawsuits in the Enron case and in numerous other cases where the value of employer stock dropped dramatically because of fraud, the bursting of the tech bubble, or the general economic malaise. The allegations run the gamut from violations of state common law standards, to breaches of the federal securities laws, to noncompliance with the Employee Retirement Income Security Act¹² (ERISA), and to violations of the Racketeer Influenced and Corrupt Organizations Act¹³ (RICO).¹⁴ The detailed, 174-page decision in *In Re Enron Corporation Securities, Derivative & “ERISA” Litigation*,¹⁵ dismissing some claims and denying defendants’ motions to dismiss in others is one indication of the complexity of these cases.

In theory employees are solely responsible for their own investment decision making. Theoretically that principle applies whether the employee makes the investment decision as part of a brokerage account that is unaffiliated with the employer, a stock purchase plan, a stock option plan, or an employer-sponsored savings plan, such as a 401(k) plan.¹⁶ Theoretically that principle still applies whether the investment of choice is employer stock or some other investment product.

In practice, though, employees do not always act as independent, rational investment decision makers. Research by behavioral economists and others shows that numerous factors, which superficially should be irrelevant, affect investment decision making.¹⁷ Federal securities law imposes disclosure requirements on many issuers of securities and prohibits fraud in connection with the sale or purchase of any security. ERISA imposes obligations on savings plans where investment decision-making responsibility is delegated to employees. State corporate law regulates the obligations of corporate fiduciaries vis-à-vis corporate shareholders. The cumulative effect of this regulatory framework means that, in fact, employees often are not solely responsible for their own investment decision making when that decision making relates to employer stock or an employer-sponsored savings or stock program. Corporate officers and directors share in that decision-making responsibility in subtle and complex ways.

What, exactly, is the scope of officer and director responsibility? What liability do officers and directors face if they do not meet their responsibilities? How do the applicable legal standards overlap? Are those standards sometimes inconsistent? The goal of this paper is to add transparency to these questions and provide a framework for future debate on these issues. It begins, in Part II, with an analysis of director and office responsibility under federal law, focusing on ERISA and securities law. It also evaluates the developing case law in this area. It continues, in Part III, with an examination of state corporation law standards. Finally, in Part IV, the paper considers the intersection of these complex legal regimes. It ends by analyzing a number of anomalous situations created by the varying standards. It also considers some options for courts and policy makers attempting to deal with the fallout from the recent market downturn and the numerous instances of corporate malfeasance.

II. Federal Law Responsibilities of Directors and Officers with Oversight of Company Stock Programs

Two very different federal law regimes affect the obligations owed by officers and directors to employees who purchase company stock through employer-sponsored programs. First, the basic federal securities laws, the Securities Act of 1933¹⁸ (‘33 Act), and the Securities Exchange Act of 1934¹⁹ (‘34 Act) govern all sales of securities. Second, in the context of employee benefit plans, ERISA defines who owes fiduciary obligations, establishes the scope and nature of those obligations, and preempts state law. This section begins by briefly discussing the implications of federal securities law for

the obligations of officers and directors of firms whose employees invest in company stock. Next, it considers the regulatory ramifications of ERISA for those officers and directors.

A. Federal Securities Laws and Employee Purchases of Company Stock

The '33 Act regulates the offer and sale of securities with its primary goal being to ensure that investors receive the information they need to make an assessment of the securities.²⁰ At its most basic level, the '33 Act requires the issuer of securities to either register the sale of its securities or qualify for an exemption from registration.²¹ When an employee invests in company stock, whether through a brokerage account unrelated to the company or through any form of company-sponsored program, the employee acquires a security that is subject to the '33 Act's "exemption or registration" requirement.²² In addition, the employee's interest in a formal employer-sponsored stock or deferred savings plan is likely to be a security under the definition of the '33 Act, resulting in the same "exemption or registration" requirement. For example, according to the Securities & Exchange Commission (SEC), a 401(k) plan that accepts employee contributions results in an employee participation interest that constitutes a security.²³ In the absence of significant differences between a stock purchase plan and the typical brokerage transaction, an employee's participation interest in a stock purchase plan is not a security even though the underlying company stock is a security.²⁴

Regulation under the '34 Act focuses on the trading of securities by imposing an array of requirements that are largely market related. It mandates that issuers with securities traded on a national exchange or with 500 or more shareholders and at least \$10 million in assets to register and comply with periodic reporting obligations.²⁵ The '34 Act also prohibits fraud in the purchase or sale of any security, without reference to whether the securities are traded on a national exchange, the number of shareholders or the amount of company assets.²⁶ This prohibition on fraud, in section 10b, is also the source of insider trading law, which includes a ban on tipping material nonpublic information to others who trade on the information.²⁷ Section 10b prohibits any material misstatement or omission made in connection with the purchase or sale of securities.²⁸ Though section 10b has broad application, the Supreme Court has established significant limitations on suits alleging section 10b violations. First, the statute does not permit aiding and abetting claims brought by private parties.²⁹ Second, a plaintiff must prove scienter on the part of the defendant.³⁰ Although the Supreme Court has not addressed whether recklessness is sufficient to establish scienter, courts of appeals utilize a recklessness standard.³¹ Third, only actual purchasers or sellers of securities may bring section 10b claims.³² Thus, an investor who is defrauded and on that basis does not purchase securities she otherwise would have purchased has no standing to bring a section 10b claim.

Another important federal securities law constraint is Regulation FD (Reg. FD).³³ Reg. FD prohibits senior management³⁴ from selectively disclosing material nonpublic information to a variety of persons listed in the rule, such as securities holders, institutional investors, and securities analysts.³⁵ Neither scienter nor breach of any fiduciary duty need to exist for a Reg. FD violation. Both Reg. FD and section 10b reduce informational asymmetry. In another provision meant to counteract informational advantages, the '34 Act provides that "insiders," defined to include officers, directors and ten percent shareholders of reporting act companies, must disgorge any profit made on purchases and sales of company securities made within a period of less than six months.³⁶

Together the '33 and '34 Acts constrain the behavior of corporate officers and directors vis-à-vis employees who purchase company stock in very much the same way as those Acts govern the relationship between corporate officers and directors and company shareholders more generally. When the company is issuing securities, the '33 Act requires that those securities be registered or qualify for an exemption from registration.³⁷ If material misstatements or omissions are made in the registration materials, the officers and directors, as well as the issuer and other parties who took part in the offering, may have liability for those misstatements or omissions.³⁸ Although the issuer is strictly liable, the officers and directors may assert a due diligence defense.³⁹

Officers and directors also need to be cognizant of their responsibilities under the '34 Act whenever they are trading in company securities or providing information to others who may trade based on that information. In one of the foundational cases on insider trading, *In re Cady, Roberts & Co.*,⁴⁰ J. Cheever Cowdin, a director of Curtiss-Wright Corporation, telephoned Robert M. Gintel, a broker and partner of Cady, Roberts & Co., during a short break in a Curtiss-Wright board meeting. Cowdin left a message telling Gintel that the quarterly dividend had been reduced.⁴¹ The SEC determined that the antifraud provisions of the '34 Act prohibited a corporate insider, such as Cowdin, from conveying material nonpublic information to someone such as Gintel, who would use that information to benefit himself or his clients. The United States Supreme Court, however, has repeatedly rejected SEC theories of insider trading that rely simply on the concept of informational equality and, instead, requires the existence of both a breach of a duty and scienter before finding a violation.⁴² Officers and directors who have scienter violate the '34 Act's fraud provisions when they trade while in possession of or tip material, nonpublic information because those actions violate the fiduciary obligation they owe to corporate shareholders.⁴³ Similarly, they cannot trade on or tip material, nonpublic information in breach of a duty owed to the source of the information.⁴⁴

Together the '34 Act's antifraud provision and Reg. FD prevent officers and directors from selectively communicating material nonpublic information about the company's prospects to employees so employees can consider the information when determining whether to invest in company stock. An officer who communicated information, such as concerns about fraud in company financial reports, to employees ahead of an announcement to the market, would violate Reg. FD. Similarly, such a targeted disclosure would violate the officer's or director's duty to all stockholders and almost certainly would be made with scienter. As a result, the statement would violate section 10b, potentially exposing the officer or director to both civil and criminal liability.

B. ERISA and Employee Purchases of Company Stock

This section analyzes the basic principles of when directors and officers assume fiduciary obligations to employees who purchase company securities through employer-sponsored stock purchase and savings plans. It also addresses the even more difficult question of the scope of those fiduciary obligations. Although the courts have been elucidating these statutory concepts since ERISA was enacted in 1974, the principles are only beginning to be applied in the context of fiduciary breaches connected to company stock in employer-sponsored plans.

1. Directors and Officers as Benefit Plan Fiduciaries

The question regarding the circumstances in which directors and officers owe fiduciary obligations to employees who purchase company securities through employer-sponsored stock purchase and savings plans is much more complex than the parallel question of fiduciary obligation to shareholders. It is further confused by the variety of benefit programs in which the question arises. The most compelling issues during the past few years have arisen in what are popularly called 401(k) plans after the statutory section of the Internal Revenue Code that authorizes those plans. For example, participants in the Enron 401(k) plan lost more than \$2 billion in the plan, primarily because of the collapse in the value of Enron stock.⁴⁵ Plan participants brought suit against a wide variety of defendants including certain Enron officers and directors⁴⁶ as did the Department of Labor (DOL).⁴⁷ In May 2004, the DOL and private plaintiffs announced a \$66.5 million settlement with some of the Enron defendants.⁴⁸ But, some claims against other Enron-related defendants remain outstanding and similar issues arise under traditional pension plans, employee stock ownership plans, and nonpension plans such as health care plans and disability plans.⁴⁹

Federal law casts a broad net in its definition of who owes fiduciary duties to benefit plan participants and beneficiaries. Unlike its corporate law counterpart, employee benefit law departs rather significantly from trust law in determining when an individual owes fiduciary obligations and the scope of actions to which the fiduciary obligations attach. First, because fiduciary status may be predicated on either formal plan terms or actual exercise of responsibility, more people are likely to become plan fiduciaries than if traditional trust law principles governed. On the other hand, however, benefit plan fiduciaries owe fiduciary obligations only when undertaking specific actions. In comparison, traditional trust law and corporate law would apply fiduciary standards to all actions taken by an individual who is a fiduciary.

As is true for other individuals and entities, a corporate director or officer may become a plan fiduciary in one of two ways. First, a benefit plan document may name the individual director or officer as a fiduciary within the terms of the plan.⁵⁰ Second, the individual may take actions that give rise to fiduciary obligations. According to the statute, a person becomes a fiduciary to the extent she exercises discretion over plan management or assets, she has discretionary authority over plan administration, or provides investment advice regarding plan assets in return for a fee.⁵¹ A "person" for statutory purposes includes corporations and other business entities.⁵²

a. Named Fiduciaries

Being individually named as a fiduciary under plan terms rarely results in disputes over fiduciary status. The situation, however, is different when the plan document names the company as the plan fiduciary. Do the individual board members or corporate officers become plan fiduciaries in such an instance?

One approach would be to find that the individual directors necessarily become plan fiduciaries regardless of their actions and involvement with the plan because it is the directors and officers who are ultimately charged with oversight and management of the company. No court seems to have taken such an aggressive stance though. In fact, the Third Circuit has decided that individual officers do not become fiduciaries simply by holding a corporate office.⁵³ Even actions by the officers who caused the corporation to breach its fiduciary obligations under the plan did not cause the officers to become fiduciaries.⁵⁴ The court appeared to find it irrelevant that the two officers also were the primary owners of the corporation and stood to personally benefit by their actions.⁵⁵

The Third Circuit reasoned that any other interpretation would fail to defer to the statutory language, which permits a plan to provide for a named fiduciary and also permits a business entity to act as a fiduciary. In the words of the court:

When a corporation is the “person” who performs the fiduciary functions . . . the officer who controls the corporate action is not also the person who performs the fiduciary function. Because a corporation always exercises discretionary authority, control, or responsibility through its employees, [the statute] must be read to impute to the corporation some decisions by its employees. Otherwise, the fictional “person” of a corporation could never be a fiduciary because a corporation could never meet the statute’s requirement of having discretion. We cannot read [the statute] in a way that abrogates a use of corporate structure clearly permitted by ERISA.⁵⁶

Under this reasoning, directors and officers only become fiduciaries if they assume individual discretionary roles over plan management, assets, or administration.⁵⁷ For example, the corporation could formally delegate at least a portion of its fiduciary obligations to a director or officer and such a delegation would give rise to individual fiduciary status.⁵⁸ But, in the absence of a delegation, actions taken on behalf of the named fiduciary would not result in a defendant assuming fiduciary obligations. Using similar logic, in a recent decision alleging fiduciary breach associated with continued plan investments in company stock in *In re Reliant Energy ERISA Litigation*, a district court in the Fifth Circuit determined that board members were not per se fiduciaries.⁵⁹

Other courts have disagreed with the Third Circuit. In *Kayes v. Pacific Lumber Co.*, the Ninth Circuit held that individual officers became plan fiduciaries.⁶⁰ The plan document designated the company as the plan’s named fiduciary and further stated that in carrying out their duties, the company’s directors and officers would be “acting on behalf of and in the name of the Company . . . and not as individual fiduciaries.”⁶¹ The Ninth Circuit explicitly disagreed with the Third Circuit’s analysis and decided that any person who undertakes actions covered by the statute’s functional definition of fiduciary status necessarily becomes a fiduciary regardless of the person’s position vis-à-vis a named fiduciary.⁶² The Ninth Circuit reasoned that the statute separately defines “fiduciary” and “named fiduciary” and does not contain an exemption from fiduciary status for functional actors who perform duties as agents of a named fiduciary.⁶³ Further, the statute forbids relieving any fiduciary from liability except through insurance.⁶⁴ The Ninth Circuit viewed the plan’s provision, which stated that directors and officers did not act “as individual fiduciaries” as a prohibited attempt to relieve fiduciaries from liability.⁶⁵ Finally, the court buttressed its decision with Department of Labor regulations that recognize fiduciary status may be based on functional activities.⁶⁶ The Ninth Circuit later extended its rationale in *Kayes* to the situation where a benefit plan designated a committee instead of the company as the named fiduciary.⁶⁷ According to the court, “where, as here, a committee or entity is named as the plan fiduciary, the corporate officers or trustees who carry out the fiduciary functions are themselves fiduciaries and cannot be shielded from liability by the company.”⁶⁸

The court in *In re Enron Corporation Securities, Derivative & “ERISA” Litigation* followed the reasoning of the Ninth Circuit.⁶⁹ The plaintiffs alleged that officers, including Kenneth L. Lay, and directors who were members of the board’s Compensation and Management Development Committee (Compensation Committee), violated their fiduciary obligations associated with Enron stock offered through the company’s 401(k) plan.⁷⁰ After acknowledging and discussing the dispute in the circuits, the *Enron* court decided that the language and policy considerations of ERISA militated in favor of potential personal liability for corporate officers and directors who act as the agents of a corporation that is a named ERISA fiduciary.⁷¹ According to the court, fiduciary status in such a situation is determined by “a functional, fact-specific inquiry to assess ‘the extent of responsibility and control exercised by the individual with respect to the Plan.’”⁷²

From a policy perspective, whether directors or officers become fiduciaries when they carry out discretionary functions assigned by a plan document to a named fiduciary that is an entity, such as a corporation, makes for an interesting question. The Supreme Court has recognized that Congress expanded the definition of who is a fiduciary for benefit plan purposes beyond its traditional scope.⁷³ The statutory provision for personal liability by fiduciaries would most effectively incent careful and compliant fiduciary conduct if discretionary acts subject individual officers and directors to fiduciary status and, thus, to liability. And, certainly, as discussed above the statutory language can be read in a way to support the Ninth Circuit’s extension of liability to individuals who act with such discretion on behalf of named fiduciaries.⁷⁴

On the other hand, the statutory definition of “person,” which lists and includes various types of business entities, implies some recognition of the separate legal status of those entities, the ability to hold them liable, and the role they play in insulating other actors, such as shareholders, from liability. Deeming directors and officers who engage in discretionary activities on behalf of a benefit plan to be fiduciaries may have an anomalous effect. Consider the situation where a plan designates the company as the named fiduciary. Under the Ninth Circuit’s rationale, any director or officer who did not take any action with respect to the plan would not be considered a fiduciary and would be protected from all liability. Any director or officer, though, who acted in the role of the company’s agent and exercised discretion with respect to the plan would be deemed to be a fiduciary and would face potential liability as a result of that exercise of discretion. In short, those individuals who ignore the need to take action as an agent on behalf of the company would be insulated from liability and leave their fellow agents, who do take action, with the potential liability.⁷⁵

b. Functional Fiduciaries

In addition to becoming a fiduciary by being named as a fiduciary in the plan documents, ERISA provides that individuals and entities that engage in particular actions vis-à-vis a plan automatically have fiduciary status for those actions. Thus, identifying precisely what actions give rise to functional fiduciary status can be extraordinarily important. Depending on the nature of the plan's terms and the jurisdiction's position on the agency debate, a director or officer who undertakes the specified discretionary actions will become a plan fiduciary. Fiduciary status based on this functional definition, however, is limited "to the extent" the individual exercises or has discretionary authority over the administration of a plan or its assets. The determination of this status tends to be a mixed question of law and fact.⁷⁶

Many of the recent decisions addressing who is a fiduciary for purposes of claims involving company stock consider the role played by various actors. For example, in *In re Electronic Data Systems Corp. ERISA Litigation*, the plaintiff sufficiently alleged that the company, board members, and relevant plan committees assumed functions sufficient to result in fiduciary status.⁷⁷ According to the plaintiffs, EDS had made favorable statements about its financial prospects but had taken on a great deal of undisclosed risk by using a "mega-deals" business model.⁷⁸ On September 18, 2002, EDS announced lower than estimated revenue and quarterly earnings that were much lower than expected.⁷⁹ The next day the stock price dropped by over 50 percent.⁸⁰ The court determined that if plaintiffs' allegations were accurate, then officers and directors became "functional fiduciaries by actually exercising authority and control respecting management of plan assets."⁸¹ The plaintiffs also argued that board members became functional fiduciaries because they appointed other plan fiduciaries and had ultimate responsibility for the actions of other fiduciaries.⁸² The court agreed that either exercising review authority or merely having a duty to monitor the fiduciaries appointed by the board would be sufficient to confer fiduciary status on the board members.⁸³

c. Settlor Functions

A trilogy of Supreme Court decisions makes clear one category of actions when benefit plan actors, including officers and directors, do not act as ERISA fiduciaries.⁸⁴ That category of actions has come to be known as settlor actions after the settlor doctrine in trust law. As applied to employee benefit plans, the settlor doctrine means that actions taken to establish, amend, or terminate an employee benefit plan are not fiduciary actions and do not create fiduciary obligations. This is true of welfare benefit plans, such as health care plans, as well as pension plans.⁸⁵ And it is true of 401(k) plans that are funded with employee contributions as well as pension plans funded exclusively by employers.⁸⁶ In the words of the Supreme Court: "ERISA's fiduciary duty requirement simply is not implicated where [the employer], acting as the plan's settlor, makes a decision regarding the form or structure of the plan such as who is entitled to receive plan benefits and in what amounts, or how such benefits are calculated."⁸⁷

Boards of directors typically have final authority to approve amendments to benefit plans or to terminate the company's plans.⁸⁸ If those decisions were subject to ERISA's fiduciary standards, which include a duty of loyalty to participants and beneficiaries,⁸⁹ the Board's fiduciary obligations under ERISA might conflict with the Board's corporate law fiduciary obligations. Consider, for example, the situation where a corporation is faced with rapidly escalating health care costs and limited financial resources. In recent years, companies in such circumstances have passed along increasing proportions of health care costs to employees or trimmed benefit entitlements.⁹⁰ Because those changes modify the terms of the employee benefit health care plan, they require a plan amendment. If the Board was obligated to consider only the best interests of plan participants and beneficiaries, it may be precluded from approving such a plan amendment. The settlor doctrine, however, establishes that this type of plan amendment, like all plan amendments,⁹¹ is not subject to ERISA's fiduciary obligations. As a result, the Board may meet its state law fiduciary obligations without fear of conflicting obligations under ERISA.

Implementation of plan amendments, like ongoing plan administration, however, is subject to ERISA's fiduciary standards. The exemplar case in this area is *Varity v. Howe*, which involved an attempt by Varity Corp. to reduce its benefit costs associated with unprofitable lines of business.⁹² In communicating its plans to the relevant employees, Varity had knowingly and significantly deceived its plan participants and beneficiaries for the purpose of saving money at their expense.⁹³ The Court determined that when communications about prospects for plan benefits were intended to help plan participants and beneficiaries make knowledgeable plan-related decisions then those communications constituted a plan administrative function.⁹⁴ As a result, those communications were acts that subjected the personnel who made them, as well as the company, to fiduciary obligations.⁹⁵

In application to the employer stock issue, where a 401(k) plan mandates the availability of employer stock as an investment option and as the vehicle for the company's matching contribution, the settlor doctrine may protect all actions taken with respect to those terms from being fiduciary actions.⁹⁶ For example, in *Crowley v. Corning, Inc.*, (*Corning II*) the court ruled that neither the corporation nor the board members were ERISA fiduciaries with respect to their decisions or lack of oversight regarding company stock.⁹⁷ The court had held in an earlier decision, *Corning I*, that the terms of Corning's 401(k) plan specified that matching contributions would be made in Corning stock.⁹⁸ In *Corning II*, the court

also interpreted the plan as requiring that employees have the option of investing their discretionary contributions in Corning stock.⁹⁹ Because the terms of the plan rather than the corporation or the board, controlled whether stock would be used to make the company's matching contribution and offered as an investment option, neither the corporation nor the board members were fiduciaries for that purpose.¹⁰⁰ In *Corning II* the court distinguished two cases where courts permitted claims associated with employer stock to go forward against fiduciaries. In both cases, *Moench v. Robertson*,¹⁰¹ and *In re WorldCom, Inc. ERISA Litigation*,¹⁰² the relevant plan documents did not absolutely mandate the use of employer stock.¹⁰³ That should have been sufficient to distinguish those cases from the *Corning II* court's use of the settlor doctrine. Intriguingly, however, the court also distinguished the decline in Corning's stock price on the facts. The plaintiffs' losses in Corning stock were attributable to Corning's business decision, which turned out in hindsight to be a poor decision but not a fraudulent one, to get into the telecom market, a market that later crashed.¹⁰⁴ In contrast, in both *Moench* and *WorldCom*, the drop in the stock price resulted at least in large part from "bad acts by corporate employees charged with fiduciary responsibilities under the plan."¹⁰⁵

2. Scope of Officer and Director Fiduciary Obligations

ERISA imposes significant fiduciary and disclosure obligations on benefit plans, businesses that sponsor those plans, and the individuals who have responsibility for the operation and management of the plans. Given the focus of this paper, this section will concentrate on the obligations of officers and directors of companies that sponsor benefit plans. It first explains the general legal standards. It then turns to an evaluation of the developing case law that addresses the scope of fiduciary liability for officers and directors of companies that provide opportunities for employees to invest in company stock through tax-favored plans.

a. Statutory Standards

ERISA enumerates the obligations of those who hold fiduciary status. First, in what is popularly known as the "Exclusive Benefit Rule,"¹⁰⁶ fiduciaries must act "for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."¹⁰⁷ This is the most complex of the duties of an ERISA fiduciary. Commentators have argued that it requires fiduciaries to be neutral in balancing the interests of various plan participants and beneficiaries.¹⁰⁸ The drafters of ERISA explicitly deviated from traditional trust law and permitted fiduciaries to take on conflicting roles, such as that of employer and plan fiduciary.¹⁰⁹ The challenge for officers and directors, then, becomes to reconcile two lines of cases. One strand of law imposes absolute loyalty on fiduciaries, setting a standard of an "eye single" to the interests of plan participants and beneficiaries.¹¹⁰ The other strand recognizes that employers may receive "'incidental' and thus legitimate benefits . . . from the operation of a pension plan . . ."¹¹¹

Second, an ERISA fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."¹¹² The focus on context and like circumstances means fiduciaries are held to the standard of an expert in the relevant area.¹¹³ There is no scienter requirement attached to claims for breach of this standard. An empty head, even when combined with a pure heart, will not protect an imprudent fiduciary.¹¹⁴ On the other hand, the prudence standard is largely a procedural standard.¹¹⁵

Third, ERISA requires fiduciaries to diversify plan investments.¹¹⁶ The DOL has recognized that fiduciary investment decisions may be considered in the context of the entire portfolio.¹¹⁷ The commentators are divided over the extent to which ERISA's diversification requirement adopts or tolerates modern portfolio theory.¹¹⁸ There is remarkably little case law on the use of modern portfolio theory to define the scope of ERISA's diversification requirement though what case law does exist tends to be supportive of the theory.¹¹⁹

Finally, a fiduciary must act in accordance with the relevant plan documents except to the extent those documents are inconsistent with ERISA.¹²⁰ The statutory obligations supersede conflicting provisions in the plan documents.¹²¹

In addition to its fiduciary provisions, ERISA requires plans to make specified disclosures to plan participants and beneficiaries, as well as to the DOL and Internal Revenue Service.¹²² From a broad perspective, the statutory disclosure provisions are similar in concept to the disclosure obligations imposed by the federal securities laws. In both instances, the statute requires periodic reporting.¹²³ In each regime, the relevant regulatory body has provided detailed guidelines on the form and content of disclosure.¹²⁴ But one important difference is that, unlike the securities laws where issuers typically have no disclosure obligation unless one is imposed explicitly by law or regulation, the trend in the case law is to recognize that benefit plan fiduciaries have some disclosure obligations beyond those found in the statute and regulation.¹²⁵

The theory underlying this additional disclosure obligation for benefit plan fiduciaries is ERISA's fiduciary framework and its grounding in traditional fiduciary principles. Trust law requires a fiduciary who knows particular information would be of interest and value to a beneficiary to convey that information to the beneficiary.¹²⁶ Courts have imposed a similar obligation on ERISA fiduciaries.¹²⁷ The problem, however, becomes the question of balancing the costs and benefits of potentially infinite disclosure requirements. On the one hand plan members could become deluged with

information, some of it of questionable value, and plan sponsors and plans might experience dramatically increased disclosure transaction costs. On the other hand, information possessed by plan sponsors and fiduciaries can be of critical value to a benefit plan participant making a decision related to plan benefits. For example, in recent years the circuits have struggled to define when plan sponsors must disclose to plan members plan amendments that are under consideration. Consider the situation of an employee who is thinking about retiring at the same time a plan sponsor is evaluating the possibility of offering a three month program that offers enhanced retirement benefits in order to reduce its workforce. The employee would want to know about the likelihood of such a program. Although the circuits articulate varying standards for when an employer must notify employees of plan amendments that are under consideration, the trend is to require such notifications.¹²⁸

b. The Developing Employer Stock Case Law

Enron, where the employees lost more than \$2 billion by investing in Enron stock through employer-sponsored plans, is perhaps the best known example of investments in employer stock that went awry.¹²⁹ But, it is far from the only situation in recent years where employees have been disappointed in the results of investing in employer stock. In the aftermath of those experiences, employees have filed numerous lawsuits alleging breach of fiduciary duty and disclosure violations. The claims are more complex than that though. For example, the Enron plaintiffs asserted breaches of fiduciary and co-fiduciary duties of prudence, diversification, care and loyalty.¹³⁰ Those claims were based, among other things, on failing properly to appoint and monitor other plan fiduciaries, causing, permitting, and encouraging employee investments in Enron stock even though the fiduciaries knew it was an imprudent investment, and locking down plan investments without adequate notice.¹³¹ The Enron plaintiffs also alleged that the plan fiduciaries failed to disclose material information the fiduciaries had knowledge of and knew would be important to employee investment decision-making.¹³² After extensive and careful analysis, the district court in Enron denied defendants' motions to dismiss on these counts as to numerous defendants.¹³³

Many of the employer stock cases stand at a similar point in litigation. The courts have begun to consider these issues, but the analytical approaches are far from consistent and the issues can be expected to trouble the courts for some time to come. The cases, then bear some significant consideration. The following discussion categorizes the claims according to whether the claim is for: (1) continuing to offer employer stock as an investment option, automatically making matching contributions in employer stock, or not permitting diversification out of employer stock when the fiduciaries knew or should have known that employer stock was an imprudent investment; (2) failing properly to appoint or monitor fiduciaries who had responsibility for investment-related decisions under the plan or communications regarding the plan; and (3) making material misstatements or omissions regarding employer stock. The authors recognize that the categories are somewhat artificial in nature and there is some overlap in the legal analysis among the claims. Still, dissecting the claims in this way helps elucidate both the applicable legal principles and the factual distinctions among the claims.

i. Employer Stock as an Imprudent Investment

Claims that, although employer stock was an imprudent investment, fiduciaries continued to offer company stock as an investment option, to cause employer matches to be made in employer stock, and to prevent employees from diversifying their plan accounts implicate all of ERISA's fiduciary obligations. Beginning with the duty of loyalty, fiduciaries may be reluctant to modify the availability of company stock in the employer plans because such an action could result in a dramatic decrease in the stock price and, thus, a decline in the value of the fiduciaries' own stock or option holdings.¹³⁴ Similarly, one can imagine a number of scenarios where the resulting decline in the stock price or even the simple understanding of the fiduciaries' lack of confidence in the company's prospects would negatively affect the fiduciaries, the company, or some other constituency.¹³⁵ If, however, the fiduciaries permit considerations other than the best interests of the plan participants and beneficiaries to enter into their decision-making process, then the fiduciaries would seem to violate their duty of loyalty to plan participants.

Although Supreme Court decisions allow companies that sponsor benefit plans to enjoy some tangential gains from plan sponsorship, the duty of loyalty is one that leaves no space for fiduciary prevarication. The oft-repeated standard that ERISA fiduciaries must act with "an eye single"¹³⁶ to the best interests of participants and beneficiaries means that fiduciaries may not offset any concerns about the detriment that may result from a change in the availability or use of company stock as a plan investment against the benefit to participants and beneficiaries from making the change. Courts consistently have recognized the importance of the principle of loyalty and permitted, in this context, employee claims based on breach of loyalty to go forward.¹³⁷

Fiduciaries who fail to reconsider the use of company stock in employer-sponsored plans also may violate their fiduciary obligation of prudence. For example, in *In re WorldCom, Inc. ERISA Litigation*, the plaintiffs alleged that plan fiduciaries failed to fulfill their responsibilities to evaluate the continued availability of WorldCom stock as an investment alternative under the plan.¹³⁸ The court agreed that plaintiffs pleaded a valid claim, writing: "To the extent . . . that any

Plan fiduciary had responsibility to decide or present it [sic] views on the wisdom of the investment options, it would have been a breach of that duty not to alert WorldCom to the need to eliminate, or at least, to consider eliminating WorldCom stock as one of the investment alternatives.”¹³⁹

Even in situations involving Employee Stock Ownership Plans (ESOPs), which by statute must be designed to invest primarily in employer stock,¹⁴⁰ courts have held that a plan fiduciary may have a duty to review the continued prudence of investments in employer stock.¹⁴¹ The ESOP cases adopt an abuse of discretion standard, giving fiduciaries a presumption of prudence for investments in employer stock, but plaintiffs may rebut the presumption by showing that “circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.”¹⁴² The absence of a statutory requirement that 401(k) plan assets be invested primarily in employer stock and the potential for conflicts of interest may militate for a more stringent level of scrutiny of fiduciary compliance with ERISA’s prudence standards in those cases, however, multiple courts have cited the ESOP presumption when analyzing a 401(k) plan fiduciary’s prudence.¹⁴³ The ESOP cases raise one further complication for the obligation of fiduciaries. As the Third Circuit noted in *Moench v. Robertson*, “[I]f the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer’s securities, it may face liability for that caution, particularly if the employer’s securities thrive . . .”¹⁴⁴ Thus, directors and officers who serve as ERISA fiduciaries must not be so conservative in their evaluation of company prospects as to imprudently eliminate company stock as an investment option or source of matching contribution.

ERISA’s diversification requirement does not apply to 401(k) plans where plan sponsors have successfully delegated the selection of investments to plan participants and beneficiaries. It is typical for 401(k) plans to delegate investment decision-making associated with their discretionary contributions.¹⁴⁵ Such a delegation provides individual plan investors with flexibility and respects their different tolerances for investment risk.¹⁴⁶ The delegation, also redounds to the benefit of plan sponsors and fiduciaries because regulations, issued in 1992, permit an employer to avoid liability for poor investment choices if the plan meets specified criteria.¹⁴⁷ The regulations were issued under ERISA section 404(c),¹⁴⁸ and, hence, are known as the 404(c) regulations. Plans that delegate investment choices in compliance with the regulations are known as participant-directed plans.¹⁴⁹

Not surprisingly, when plaintiffs who are members of participant-directed plans assert that their discretionary investments in company stock violate ERISA’s diversification requirements, plan fiduciaries typically defend on the basis that ERISA section 404(c) precludes liability associated with the selection of investments.¹⁵⁰ Section 404(c), however, provides fiduciaries with only an affirmative defense and, thus, typically is inappropriate for resolution on a motion to dismiss.¹⁵¹ Perhaps more significantly, section 404(c) does not protect fiduciaries from liability for investment decisions unless the plan participants have the right to and in fact do exercise control over their plan accounts.¹⁵² In *In re Enron Corp. Securities, Derivative & “ERISA” Litigation*, plaintiffs alleged that the fiduciaries’ failure to disclose material facts about Enron’s true financial situation precluded the plaintiffs from exercising the necessary independent control over their plan accounts.¹⁵³ The Enron plaintiffs also contended that the plan fiduciaries did not qualify for section 404(c) protection because the plan “did not provide a broad range of diversified investment options, liberal opportunities to transfer assets among allocations, and sufficient information to make sound investment decisions, nor did the plan provide the requisite notice to participants that it intended to qualify as such a plan.”¹⁵⁴ Plaintiffs in other cases have made similar arguments.¹⁵⁵ As the *Enron* court stated: “If a plan does not qualify as a [section] 404(c), the fiduciaries retain liability for all investment decisions made, including decisions by the Plan participants.”¹⁵⁶

ii. Failing to Properly Appoint or Monitor Plan Fiduciaries

Appointing plan fiduciaries is a fiduciary function and appointment brings with it an obligation to monitor those fiduciaries.¹⁵⁷ Plaintiffs who allege wrongdoing associated with company stock investments frequently allege that corporate directors or officers, who have appointment authority over plan administrators or plan investment committee members, failed in their obligation to properly appoint or monitor those lower level plan fiduciaries. For example, in *Enron* the plaintiffs brought a claim against Kenneth Lay “for breach of his fiduciary duty to monitor the appointment and conduct of the Savings Plan and ESOP Committee Members.”¹⁵⁸ Similarly, in *Rankin v. Rots*, the plaintiffs alleged that Charles A. Conaway, Chairman, CEO, and Director of K-Mart Corporation breached his fiduciary obligations to them by “failing to monitor or evaluate the performance of those appointed by him to fiduciary capacities . . .”¹⁵⁹

Claims attempting to categorize board members and officers as fiduciaries because of their oversight capacity have not always been successful in surviving motions to dismiss in the employer stock cases. For example, in *In re WorldCom, Inc. ERISA Litigation*, the plaintiffs alleged that WorldCom’s status as Plan Administrator and Investment Fiduciary, as designated by the plan, meant that the company’s directors had fiduciary responsibility to appoint and monitor plan fiduciaries.¹⁶⁰ The plaintiffs attempted to reinforce their argument by relying on the law of Georgia, where WorldCom was incorporated and which provides, as do most state corporation statutes, that boards of directors have the responsibility to oversee the corporation’s business and management.¹⁶¹ The court concluded that the plaintiffs’ argument proved too much because its logical result would be that every person who supervised an ERISA fiduciary automatically would become an

ERISA fiduciary.¹⁶² Nor does the argument appropriately recognize the difference between board members' obligations as plan settlors,¹⁶³ which do not result in any fiduciary duty, and the obligations of plan fiduciaries.¹⁶⁴

The opposing approaches developed by the courts raise interesting implications for corporate officers and directors and for policy makers. Officers and directors will need to decide in the short term whether there is more risk in exercising appointment and oversight opportunities or in avoiding those responsibilities. Policy makers might look to either traditional fiduciary principles or to corporate law for guidance. Traditional trust law, however, typically has precluded trustees from delegating responsibility¹⁶⁵ making that an inapt source of authority. Corporate law, on the other hand, has confronted the question of officer and director oversight responsibility in a variety of contexts. The basic legal principles are discussed below in Part III¹⁶⁶ and implications of those principles for the employer stock cases are discussed in Part IV.¹⁶⁷

iii. Material Misstatements and Omissions

The third category of complaints frequently raised by plaintiffs who have been harmed by making an investment in company stock through employer-sponsored plans consists of claims related to alleged misstatements or omissions about the stock or about the company's prospects more generally. These allegations are sometimes raised in order to argue that a particular person or entity is an ERISA fiduciary. For example, in *In re WorldCom, Inc. ERISA Litigation*, the plaintiffs alleged that company directors became ERISA functional fiduciaries by signing SEC filings made on behalf of WorldCom.¹⁶⁸ Some of those filings even incorporated ERISA-required documents and some ERISA-required documents incorporated SEC documents by reference.¹⁶⁹ The court, however, declined to find that signing the SEC filings caused the directors to become ERISA fiduciaries. In a rather cursory manner, the court determined that the directors signed those documents in their corporate roles and not in their roles as ERISA fiduciaries.¹⁷⁰

The *Enron* court confronted at some length the difficult questions subsumed in allegations that the plaintiffs had been misled about the value of Enron stock. The court's opening statement on the issue is a warning: "The fiduciary's duty to disclose is an area of developing and controversial law."¹⁷¹ Two basic principles in the area do, however, seem to be generally accepted. First, it is a breach of fiduciary duty to make an affirmative misrepresentation about future benefits that would induce reliance by a reasonable person.¹⁷² Second, the Supreme Court has left open the question of whether a fiduciary has an affirmative obligation to make disclosures in the absence of a specific statutory or regulatory obligation and a direct question from a participant.¹⁷³

Ultimately, the *Enron* court found that the plaintiffs sufficiently stated claims against a number of defendants for failure to disclose. Both Enron and the Compensation Committee allegedly withheld information about Enron's actual financial condition from the Administrative Committee.¹⁷⁴ Furthermore, a wide variety of fiduciaries including the directors on the Compensation Committee and Kenneth Lay "allegedly breached their fiduciary duty to protect the plan participants and beneficiaries through failure to disclose to them . . . that what they knew or should have known, through prudent investigation, was a threat to the pension plans or to correct any material misinformation."¹⁷⁵

The developing doctrine on director and officer obligations to disclose in the context of company stock offered through employer-sponsored plans raises some serious questions. Certainly, it seems to be a compelling argument that officers and directors should no more be able to mislead employees who purchase company stock than to mislead non-employees who purchase company stock. One of the foundational concepts of the federal securities laws is to prevent fraud in the sale and purchase of securities.¹⁷⁶ The critical question, however, is the extent to which ERISA fiduciaries have disclosure obligations in excess of those imposed by the federal securities laws. Should employees be entitled to additional protections because of the risk they accept when investing both their human and financial capital in the same enterprise? Or should the employees be held accountable for the additional risk they take when putting all their eggs in one basket, so to speak? Should plan fiduciaries face a higher level of fiduciary duty vis-à-vis the offering of company securities through employer-sponsored benefit plans because the fiduciaries have exceptional access to company information and it may benefit the company, for example for tax purposes and by putting stock in friendly hands, to offer company stock through the plans? Or, should plan fiduciaries be protected against extensive disclosure obligations under ERISA in order to encourage employee ownership and all of the benefits such ownership can bring to the company and the employees?¹⁷⁷

Rationalizing disclosure duties under ERISA and the federal securities laws has been a challenge for the courts. In *Rankin*, Conaway, the K-Mart Chairman, CEO, and Director, and the outside directors argued that even if they had any fiduciary duties under ERISA to disclose information about K-Mart's prospects that "they could not as a matter of law [have] breached them because to have disclosed non-public information about Kmart would have violated securities laws."¹⁷⁸ The courts have taken different approaches to that argument in the employer stock cases. One court, though not deciding the motion to dismiss claim on that basis, assumed it was correct.¹⁷⁹ In *In re McKesson HBOC, Inc. ERISA Litigation*, the district court went further and stated "Fiduciaries are not obligated to violate the securities laws in order to satisfy their fiduciary duties."¹⁸⁰ The *Rankin*,¹⁸¹ *WorldCom*,¹⁸² and *Enron*¹⁸³ district courts, however, all rejected the argument. In general, it appears that ERISA fiduciaries can and should satisfy their disclosure duties under ERISA and the

federal securities laws even though that may require public disclosures beyond those needed to meet the minimum standards of the securities laws.¹⁸⁴

3. Remedial Limitations

Even if plaintiffs are successful in identifying plan fiduciaries and proving those fiduciaries breached their obligations, plaintiffs still face a remedial hurdle. If the employer-sponsored plan remains in place, the participants and beneficiaries could seek recovery to the plan.¹⁸⁵ ERISA explicitly grants a court broad discretion in fashioning relief that flows to a plan and the fiduciaries may be held personally liable.¹⁸⁶ However, claims based on fiduciary breaches associated with employer stock would almost certainly result in individualized losses depending on the amount of stock held in an employee's account, that employee's maximum permitted deferral, and, perhaps, the employee's investment choices. Although it would be inconsistent with both the language and intent of the statute and relevant Supreme Court precedent, it is possible that courts will decline to award relief that will flow to benefit plan accounts where such relief is necessarily individualized.¹⁸⁷

An employee with a valid fiduciary breach claim who cannot claim relief flowing to the plan, perhaps because of the foregoing limitations or perhaps because of the demise of the employer and the plan, may attempt to state a claim for relief under ERISA's catch-all remedial provision. In *Great-West Life & Annuity Insurance Company v. Knudson*,¹⁸⁸ a five-person majority of the Supreme Court construed that provision, which permits "other equitable relief"¹⁸⁹ to include only traditional equitable relief and to exclude money damages. Three barriers exist for plaintiffs seeking "appropriate equitable relief" under section 502(a)(3)(B) after *Great-West*. First, in order for a plaintiff to obtain restitution, the defendant typically must be unjustly enriched.¹⁹⁰ Second, in order to obtain *equitable* restitution, the defendant may need to possess specific property of the plaintiff's.¹⁹¹ Third, even if the defendant has been unjustly enriched and is holding specific property of the plaintiff's, according to section 502(a)(3)(B), equitable relief must be appropriate.¹⁹²

Each of these three limitations may prevent recovery by a defendant who has suffered as a result of a fiduciary breach. The Supreme Court, however, has yet to confront the issue of whether claims for fiduciary breach necessarily result in relief being equitable under section 502(a)(3)(B) and there would be good reason for the Court to distinguish its prior remedial cases. A phrase from *Great-West* helps clarify the fundamental question in the fiduciary breach cases. The Court stated that: "whether [restitution] is legal or equitable depends on the 'basis for [the plaintiff's] claim' and the nature of the underlying remedies sought."¹⁹³ Thus, the inquiry in the typical case requires a two-pronged examination of both the basis of the claim and the type of remedy at issue. In some cases these two factors might point in different directions. And, the specific question is whether, in situations of fiduciary breach, it might be enough that the cases are substantively equitable. In theory, that is a reasonable basis on which to categorize cases as equitable. The equity courts created trust law and, in that sense at least, trust and fiduciary standards are peculiarly equitable.¹⁹⁴

III. Corporate Law Responsibilities of Directors and Officers

The concept of fiduciary duty, as applied to corporate officers and directors, is also a significant part of the corporate law jurisprudence. It is well-established law that the corporate officer and director owe fiduciary duties to the corporation and its shareholders.¹⁹⁵ The most salient duties are the duties of care and loyalty,¹⁹⁶ juxtaposed with the obligation to act in good faith.¹⁹⁷ A review of this body of law yields some insights that may be instructive in helping to define the contours of the liability officers and directors face in their roles as ERISA fiduciaries.

Like the fiduciary duty standards that are a part of the ERISA jurisprudence,¹⁹⁸ the fiduciary duties in corporate law had their genesis in the law of trusts.¹⁹⁹ A fiduciary relationship exists, "when one is given power that carries a duty to use that power to benefit another."²⁰⁰ This relationship is placed upon trustees and their beneficiaries and upon agents and their principals.²⁰¹ Although corporate officers and directors as fiduciaries are not formally considered trustees of the organizations they serve,²⁰² corporate law analogizes to the fiduciary obligations of trustees when determining the scope of corporate fiduciary duties,²⁰³ albeit without much discussion. One of the reasons why corporate law draws so heavily on trust law jurisprudence seems to be the early suspicion of private power of corporations. When public investments in corporations increased, corporate scandals and fiduciary mismanagement became a matter of public policy.²⁰⁴ The laws generated in response were focused on the shareholders' rights. These rights are similar to those reserved for trust beneficiaries, both aiming to protect the interests of those whose money is being handled by others.²⁰⁵

Review of the early cases addressing the fiduciary obligations of corporate officers and directors reveals that their duties are analogous to those found in the trust relationship. The following section considers the corporate law duties in this context.

A. Corporate Law Foundation in the Law of Trusts

According to the Restatement of Trusts, a “trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill as he has.”²⁰⁶ The Restatement notes, in the Comment to this section:

the standard of care and skill required of a trustee is the external standard of a man of ordinary prudence in dealing with his own property. A trustee is liable for a loss resulting from his failure to use the care and skill of a man of ordinary prudence, although he may have exercised all the care and skill of which he was capable. On the other hand, if the trustee has a greater degree of skill than that of an ordinary man, he is liable for a loss resulting from the failure to use such skill as he has.²⁰⁷

The Restatement further notes the liability that attaches for failure to adhere to this standard.

Section 205 provides for the Liability in case of Breach of Trust as follows:

If the trustee commits a breach of trust, he is chargeable with

(a) any loss or depreciation in value of the trust estate resulting from the breach of trust; or

(b) any profit made by him through the breach of trust; or

(c) any profit which would have accrued to the trust estate if there had been no breach of trust.²⁰⁸

The origin of the corporate law duty of care may go back to the 1742 English case of *Charitable Corp. v. Sutton*,²⁰⁹ where the court found the directors of a charitable organization liable for failure to oversee loans to other directors.²¹⁰

According to the court “[b]y accepting of a trust of this sort, a person is obliged to exercise it with fidelity and reasonable diligence.”²¹¹ One of the early cases articulating the corporate standard of care in the United States, utilized language from the law of trusts in assessing the obligations of bank directors. In *Hun v. Cary*,²¹² decided in New York in 1880, the court found that by voluntarily serving as a director, the individual “invites confidence in that relation,”²¹³ and required the directors to exercise “the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs.”²¹⁴ This duty has been extended to non-banking corporations, at least as early as 1891, as articulated by the U.S. Supreme Court in *Briggs v. Spaulding*.²¹⁵ The Supreme Court defined the corporate fiduciary standard as that of “ordinarily prudent and diligent men.”²¹⁶

The Delaware courts have followed suit in their analysis of the ambit of the corporate fiduciary standards. In *Lofland v. Cahall*,²¹⁷ the Delaware Supreme Court picked up on the analogy to the law of trusts in describing directors as trustees for the shareholders.²¹⁸ In 1926, the court in *Bodell v. General Electric Corp.*,²¹⁹ noted that although directors “are not trustees in the strict sense of the term . . . With respect to unissued stock they are said to control it as trustees.”²²⁰ The court further found that “It is not always necessary . . . to reap a personal profit or gain a personal advantage in order for their actions in performance of their quasi trust to be questioned . . . They owe the duty of saving their beneficiaries from loss.”²²¹

Thus, analogous to the standard of care found in trust law, the corporate law standards as articulated by the early courts were framed in terms of negligence.²²² Yet, as noted some time ago by Professor Bishop, the search for cases where directors were held liable for breach of that standard is like searching for needles in a haystack.²²³ Although the duty of care is described in terms of negligence,²²⁴ the courts did not generally find liability for its breach. The next section discusses this divergence from trust law.²²⁵

B. Corporate Law Divergence from the Law of Trusts: The Business Judgment Rule and Gross Negligence

Along with the common law development of the corporate fiduciary duty of care came judicial reticence for second-guessing good faith business decisions. This appears to have been due to the development of a rule commonly known as the business judgment rule.²²⁶ Here, the duty of care in the corporate arena diverges significantly from its counterpart in trust law. Innocent mistakes do not give rise to corporate law liability.

According to Justice Horsey of the Delaware Supreme Court, judicial deference to business decisions goes back to 1742, to the English case of *Charitable Corp. v. Sutton*,²²⁷ the “father” of what is commonly referred to today in this country as the so-called “business judgment rule.” A Louisiana court similarly expressed deference for business decisions in 1829 in *Percy v. Millaudon*,²²⁸ followed in 1850 by a court in Rhode Island in *Hodges v. New England Screw Co.*²²⁹ The *Hodges* court exonerated the directors for an innocent mistake made in good faith.²³⁰ Taken further in 1940 by a court in New York in *Litwin v. Allen*,²³¹ it was determined that “not being insurers, directors are not liable for errors of judgment or mistakes while acting with reasonable skill and prudence.”²³²

The business judgment rule was described later by the Delaware Supreme Court in *Aronson v. Lewis*²³³ as protection available to directors who:

have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties. While the Delaware cases use a variety of terms to describe the

applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.²³⁴

The American Law Institute formulation of the business judgment rule has been adopted by many states, and is put forth as follows:

A director or officer who makes a business judgment in good faith fulfills the [duty of care] if the director or officer (1) is not interested in the subject of his business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.²³⁵

Commentators have articulated a number of theories to explain why courts defer to business decisions. One theory involves concern that managers would become too risk-averse in their decision making.²³⁶ Another is concern that competent people would not be willing to serve as officers and directors without protection for mistakes.²³⁷ Courts frequently justify the business judgment rule by stating that they are without authority to substitute their judgment for the informed business judgment of the directors.²³⁸ Recently, when asked whether the business judgment rule is still the law, Chief Justice Veasey of the Delaware Supreme Court replied “Yes it is. We will not second-guess your business judgment, but we are going to look at your process.”²³⁹

Although courts have articulated several formulations of the business judgment rule throughout the years, it can be generally summarized as applicable where there is: (1) no evidence of self dealing; (2) a reasonably informed decision, (3) a decision that reasonably serves the interests of the corporation; and (4) a decision that was made in good faith.²⁴⁰

C. Modern Formulations of the Duty of Care in Corporate Law

Although there are a number of slight variations in the requirements, today the duty of care generally requires officers and directors to act with the care of the reasonable person, acting in similar circumstances.²⁴¹ As mentioned above, however, courts do not find liability for violation of this standard of care unless the act is considered grossly negligent. The Delaware Supreme Court has found evidence of gross negligence where the board failed to obtain all reasonably available information before making a decision.²⁴² The duty of care has thus emphasized decision process as opposed to outcomes.²⁴³ Furthermore, the business judgment rule serves to protect decisions made in good faith,²⁴⁴ and in the best interest of the corporation and its shareholders.²⁴⁵ If these requirements are met, courts will generally not second-guess business decisions²⁴⁶ even if those decisions result in negative outcomes.²⁴⁷

The modern cases involving claims for breach of the duty of care can be categorized by the nature of the alleged violation. The first type of case involves business decisions made by the defendant officers or directors that shareholders find contrary to their best interest. The second category involves potential liability for failing to oversee the activity of others.

1. Business Decisions of Officers and Directors

For example, *Shlensky v. Wrigley* is a case where the defendant sought protection of the business judgment rule in defense of his decision.²⁴⁸ The minority shareholders of the corporation owning the Chicago Cubs baseball team alleged that management's decision to not install lights in Wrigley Field and schedule night games constituted a violation of the duty of due care.²⁴⁹ The allegation was that the firm would be more profitable if lights were installed because the ability to play night baseball would bring in more revenue.²⁵⁰ Plaintiff further claimed that Mr. Wrigley defended the decision by contending that baseball was day time sport, and that the corporation needed to be attentive to the needs of the local community where the ballpark was located.²⁵¹ The court applied the business judgment rule to the facts of the case and found no violation of the duty of care.²⁵²

In 1985, the Delaware Supreme Court decided the case of *Smith v. Van Gorkom*.²⁵³ *Smith v. Van Gorkom* has become known in the corporate arena as "Joshua's trumpet,"²⁵⁴ being the first significant case²⁵⁵ where the Delaware courts found gross negligence, and therefore liability for breach of the duty of care. This case involved the allegation that members of the board of directors violated their duty of care by approving and recommending that the shareholders accept a merger proposal.²⁵⁶ The company, Trans Union Corporation, was engaged in the railcar leasing business and had accumulated a significant amount of investment tax credits that they were unable to utilize.²⁵⁷ The company thus had been exploring various methods that would cause an increase in taxable income.²⁵⁸ A sale to a larger company with high taxable income was preliminarily discussed, with the chief financial officer (CFO) “running the numbers” and finding a range of sale prices roughly between \$50-60 per share.²⁵⁹ Its chief executive officer, Jerome Van Gorkom, asked the controller to determine the feasibility of a leveraged buyout assuming a \$55 share price, and told no other member of the company.²⁶⁰ These numbers were apparently being discussed in a meeting that Van Gorkom had with the Pritzker group, resulting in an offer by Pritzker to buy the company at a price that was 48% over the prevailing market price.²⁶¹ Van Gorkom called a special board meeting, made a twenty minute presentation to the board, and after a couple hours of deliberation, the board

voted to recommend the proposal to the shareholders.²⁶² The shareholders voted in favor of the transaction and the merger took place.²⁶³

Alden Smith, one of the Trans Union shareholders, filed a class action suit against the board alleging that the board breached its duty of care in voting in favor of the merger.²⁶⁴ Smith's allegation was that the company was worth \$100 million more than the price paid by the Pritzker group and that by recommending that the shareholders accept the offer the directors breached their fiduciary duty to the shareholders.²⁶⁵ In the end, the Delaware Supreme Court agreed with the allegation that the board did not fulfill its duty of care, and that the business judgment rule therefore, did not apply.²⁶⁶ The defect revolved around the process. The Court found that the directors were grossly negligent and did not seek all information reasonably available to them and thus did not calculate the true intrinsic value of the company before voting to accept the proposal.²⁶⁷ It was insufficient to rely on the twenty minute presentation by Van Gorkom or the statement by the CFO that \$55 was a fair price per share for the company.²⁶⁸ The Court noted that there was no investment banking opinion, although it also pointed out that the due care requirements could have been satisfied without one, and no true market test of valuation.²⁶⁹ The attempt by the defendants to solicit other bids was considered faulty by the court because of the various provisions in the agreement with Pritzker that essentially locked others out of the bidding process.²⁷⁰

The main lesson to be gleaned from *Van Gorkom* involves the significance of the due care requirement to obtain all reasonably available information before making a business decision. The directors in *Van Gorkom* were held grossly negligent for their failure to ascertain the true intrinsic value of the company before voting in favor of the merger proposal.²⁷¹ The Delaware Supreme Court applied the *Van Gorkom* precedent in 1993 in *Cede & Co. v. Technicolor, Inc.*,²⁷² where it found that the directors' failure "to inform themselves fully concerning all material information prior to approving the merger agreement"²⁷³ constituted a breach of the duty of care negating the benefit of the presumptions that the business judgment rule would normally provide.²⁷⁴

The Delaware Chancery Court recently considered an allegation of breach of duty of care in the context of business decisions in *In re General Motors Class H Shareholders Litigation*.²⁷⁵ In this case, the shareholders challenged the fairness of transactions that involved the spinning off a subsidiary of General Motors (GM).²⁷⁶ Plaintiffs claimed that the directors of GM violated their duty of care with regard to these transactions.²⁷⁷ The court disagreed.²⁷⁸ Disinterested shareholders of GM had voted to approve the transactions. The court found that the GM directors acted with a business purpose in proposing the spin-off and that the shareholders were well informed and not coerced by management in connection with their vote. The actions of the directors were thus protected by the business judgment rule.²⁷⁹

2. Oversight Responsibility for Activities of Others

An arena that appears more difficult for the courts involves the contours of the duty of care of directors when the wrongdoing was committed by others in the corporation. It has become clear that directors may not turn a blind eye toward corporate affairs and expect to avoid liability. What is less clear is just how much responsibility they have for oversight.

*Francis v. United Jersey Bank*²⁸⁰ illustrates the principle that directors must be active in corporate affairs. In this case, the officers of the company had run the company into bankruptcy by looting it.²⁸¹ The case involved the liability of a nonactive director, Mrs. Pritchard, who had not attended board meetings and had not read financial statements, and knew essentially nothing about the business.²⁸² Mrs. Pritchard's husband had been the CEO of the company. Mrs. Pritchard had inherited a 48% share of the company and had served as a director in name only.²⁸³ Although it had begun before Mr. Pritchard died, after his death, the officers, her sons, embezzled funds in earnest.²⁸⁴ The court found that the fraud was obvious, and if Mrs. Pritchard had merely looked at the statements, she should have detected it.²⁸⁵ There was no allegation that Mrs. Pritchard had participated in the fraud or that she had knowledge of it. But her failure to be active in corporate affairs meant that the business judgment rule was unavailable in her defense – she was required to have some basic knowledge of corporate workings.²⁸⁶ The business judgment rule may be a defense for business decisions, but in Mrs. Pritchard's case, there was no decision to defend.

In 1963, the Delaware Supreme Court had occasion to consider whether directors breached their duty of care in *Graham v. Allis-Chalmers Mfg. Co.*²⁸⁷ for failing to prevent employees from violating antitrust laws. There was no evidence that the directors had knowledge of the antitrust violations. It was alleged that the directors failed to learn of and prevent antitrust activity, and even if they had not known about the violations, they should have had some system in place to detect them.²⁸⁸ About thirty years prior to the case against the directors, the company had entered into consent decrees with the Federal Trade Commission regarding prior antitrust activity.²⁸⁹ The earlier consent decrees were entered into to avoid a formal proceeding.²⁹⁰ The decrees enjoined the company and nine others from entering price fixing agreements.²⁹¹ None of the defendant directors in the 1963 case had been directors when the consent decrees were entered.²⁹² The *Allis-Chalmers* court stated that "the individual director defendants are not liable as a matter of law merely because, unknown to them, some employees of Allis-Chalmers violated that anti-trust laws thus subjecting the corporation to loss."²⁹³ The Court noted that the question of liability for neglect is determined by the circumstances.²⁹⁴ The Court further stated that liability would attach if the directors had "recklessly reposed confidence in an obviously untrustworthy employee, has refused or neglected cavalierly to perform his duty as a director, or has ignored either willfully or through inattention obvious danger

signs of employee wrongdoing.²⁹⁵ The facts of the *Allis-Chalmers* case however, did not rise to this level of egregiousness.

More recently, the Delaware Chancery Court addressed the oversight function in *In re Caremark International Inc.*²⁹⁶ The *Caremark* employees were investigated for violations of various healthcare laws involving the prohibition of kickbacks for referrals of medical supplies and equipment.²⁹⁷ The Chancery Court attempted to distinguish the facts of *Allis Chalmers* from the facts of the case before it and articulated a duty to set up systems to attempt to insure compliance with laws by those in the field.²⁹⁸ "A director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that the failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards."²⁹⁹

In *Guttman v. Huang*, shareholders of NVIDIA, a technology firm, alleged that the board did nothing to prevent the accounting irregularities that eventually required the company to restate its earnings.³⁰⁰ There were also allegations of violations of laws prohibiting insider trading.³⁰¹ The plaintiff's complaint was dismissed for lack of evidence that the board knew of the accounting irregularities and did nothing to stop them.³⁰² According to the court, there must be a showing that the directors knew that they were not doing their jobs before directors will be held liable for failure of oversight under *Caremark*.³⁰³ "Only a sustained or systematic failure of the board to exercise oversight - such as an utter failure to attempt to assure a reasonable information and reporting system exists - will establish the lack of good faith that is a necessary condition to liability."³⁰⁴

In *Beam v. Stewart*,³⁰⁵ plaintiffs claimed that the board of directors owed them a "duty to monitor the personal affairs of an officer or director," in this case referring to a duty to monitor the personal affairs of Martha Stewart. The court stated there is no separate fiduciary duty to monitor, but rather this duty emanates from either the duty of care or the duty of loyalty.³⁰⁶ The court applied the reasoning of *Graham v. Allis-Chalmers Manufacturing Co.*,³⁰⁷ noting that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."³⁰⁸ The *Beam* court then held that it was "patently unreasonable" to require the board of directors to "preemptively thwart a personal call from Stewart to her stockbroker or to fully control her handling of the media attention that followed as a result of her personal actions."³⁰⁹

3. Requirement of Good Faith

As mentioned above, the duty of care and its business judgment rule corollary require that the actions of the officers and directors have been made in good faith. This requirement, in corporate law, is still developing and appears to be considered, at least by some commentators and courts, as a separate fiduciary duty.³¹⁰ Chief Justice E. Norman Veasey, of the Delaware Supreme Court has commented that in his view "it seems that there is a separate duty of good faith, not only arising out of our case law, but also as a matter of statutory construction."³¹¹ The statute that the Chief Justice refers to is section 102 (b) (7) of the Delaware Code which permits exculpation of directors for monetary damages for due care violations but expressly excludes exoneration for breach of the duty of loyalty or "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."³¹² Furthermore, according to the Chief Justice "good faith requires an honesty of purpose and eschews a disingenuous mindset of appearing or claiming to act for the corporate good but not caring for the well being of the constituents of the fiduciary."³¹³

In May, 2003, the Delaware Chancery court denied a motion to dismiss the claims against the directors of The Walt Disney Company alleging lack of good faith and breach of due care in the context of the board's approval of an employment agreement.³¹⁴ An earlier complaint was dismissed in *Brehm v. Eisner*, because the complaint did not allege sufficient facts to overcome the presumption of the business judgment rule.³¹⁵ The later complaint alleged that the "board of directors consciously and intentionally disregarded their responsibilities."³¹⁶ The court let the claim stand for determination on whether the board "exercised any business judgment or made any good faith attempt to fulfill the duties they owed to Disney and its shareholders."³¹⁷ In essence, the case involves the claim that the board of directors gave CEO Michael Eisner full authority to negotiate the employment contract for the Disney presidency with his friend, Mr. Ovitz. It was alleged that neither the full board, nor the compensation committee reviewed the terms of the contract.³¹⁸ There were also issues raised concerning the later no-fault termination of the contract on terms quite favorable to Ovitz. There is no record of the full board or of the compensation committee reviewing these terms.³¹⁹

Casting this case as one involving lack of good faith has significant ramifications for the corporate arena. As noted above, and after the decision of the Delaware Supreme Court in *Smith v. Van Gorkom*, the Delaware legislature, as well as most other state legislatures, passed laws permitting corporations to limit or eliminate monetary liability of directors for actions involving breach of the duty of care.³²⁰ However, statutory exculpation is not available to protect actions lacking good faith.³²¹ Thus, if failure to monitor is considered lack of good faith, directors will find no protection in the exculpatory statutes. Moreover, because these cases involve failure to act, there is no business decision for which to seek protection under the business judgment rule.

B. Duty of Loyalty

The second fiduciary duty applicable to officers and directors is the duty of loyalty. This duty also emanates from the Law of Trusts.³²² According to the Restatement of Trusts, the trustee's duty of loyalty is "a duty to the beneficiary to administer the trust solely in the interest of the beneficiary."³²³ Regarding transactions presenting conflicts of interest, the trustee "is under a duty to the beneficiary to deal with him and to communicate to him all material facts in connection with the transaction which the trustee knows or should know."³²⁴

One of the more famous cases discussing the contours of the duty of loyalty in the context of a business relationship is *Meinhard v. Salmon*.³²⁵ The *Meinhard* case involved application of the duty to a joint venture relationship. Chief Justice Cardozo, addressing the duty of joint adventurers to each other, said that they owe one another "the duty of the finest loyalty."³²⁶ He further stated that "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."³²⁷

The duty of loyalty has found its way into the corporate law jurisprudence. It requires directors and officers to act in good faith and in the honest belief that the action taken is in the best interests of the corporation. This duty requires avoidance of conflicts of interest, which includes an obligation of corporate officers and directors to refrain from using their corporate position of trust and confidence for their own benefit.³²⁸ It "requires officers and directors not profit at the expense of their corporation, whether through self-dealing contracts, usurpation of corporate opportunities or other means."³²⁹ In *Guth v. Loft*,³³⁰ the Delaware Supreme Court analogized to the law of trusts in finding the action of the president and director liable for breach of the duty of loyalty for taking personal advantage of an opportunity that came to him because of his position in the corporation.³³¹ The Court said that directors are obligated to "affirmatively . . . protect the interests of the corporation committed to his charge."³³²

IV. A Coherent Approach to Director and Officer Obligations Vis-à-vis Employee Investment in Company Stock

It should be apparent at this point that courts and policy makers faced with ascertaining the obligations of corporate directors and officers with respect to the use of company stock in employer-sponsored plans face a series of complex and intersecting legal frameworks. To increase the transparency of the complexities, this section will consider ways in which the legal standards interact. It also will suggest areas of particular concern as the courts and policy makers confront the fallout from the recent market downturn and the numerous instances of corporate malfeasance.

A. Anomalies and Analogs – Securities Law and ERISA

The various regulatory regimes that apply to employee stock purchases made through employer-sponsored plans intersect in some anomalous ways. As a result, employees who have ERISA claims attributable to an event related to employer stock may have very different legal rights from an equivalently situated employee whose claim is not associated with an employer plan or when compared to an investor who is not affiliated with the company. Furthermore, the minimum standard established by ERISA may affect officer and director obligations under the federal securities laws.

1. Affirmative Disclosure

As discussed above, the courts have struggled in recent years to establish the extent to which the affirmative disclosure obligations of ERISA fiduciaries exceed ERISA's periodic and other set reporting requirements.³³³ Although the parameters of this disclosure obligation have not been clearly delineated, it is generally accepted that employers must disclose expected plan amendments to employees who inquire when the amendments reach the stage of serious consideration.³³⁴ This requirement is based in the trust law principle that fiduciaries must communicate information that the fiduciary has reason to know would be important to the beneficiary.³³⁵ Using somewhat the same concept, some courts have held that plan fiduciaries have some obligation to evaluate lack of diversification due to large holdings of company stock in an employer-sponsored plan at least when the company faces severe financial challenges.³³⁶ The *Enron* court went a step further on the disclosure issue and determined that ERISA might require the fiduciaries to disclose the risks associated with company stock even if that entailed the release of material, nonpublic information.³³⁷ To the extent the courts generally accept this type of affirmative disclosure obligation, this also will affect reporting obligations under the securities laws. In the absence of a periodic disclosure requirement, such as a quarterly report, the federal securities laws typically do not require firms to disclose material nonpublic information.³³⁸ In fact, during so called "quiet periods," such as when an issuer is in the process of registering its securities, the federal securities laws may prohibit the disclosure of material, nonpublic information that would condition the market favorably toward the purchase of the issuer's stock.³³⁹

Once fiduciaries become obligated, however, for any reason, to disclose material nonpublic information to one group of stockholders, such as employees who hold company stock through an employer-sponsored plan, Reg. FD and

section 10b of the '34 Act require the contemporaneous public disclosure of that information.³⁴⁰ Some courts, such as the *Enron* court, and the DOL have reasoned that making this additional disclosure would resolve any inconsistencies between obligations under ERISA and the federal securities laws.³⁴¹ They have not, though, discussed the oddity of federal securities law disclosure policy being driven by a labor statute. If economic or business strategy reasons supported a securities law policy that gave corporate actors flexibility in timing disclosures then do the implications for employee stockholders really supersede that general policy? Nor have policy makers explicitly considered the possible conflict between ERISA's affirmative disclosure requirements, to the extent those disclosure requirements exist, and the securities laws limitations on disclosure during times such as while the issuer is in the registration process.

2. Purchase or Sale Requirement

Once an officer or director makes a statement regarding company stock, the possibility arises that the statement may be deceptive. In such an instance, the federal securities laws provide quite different standards governing the legal liability of the officer or director from the standards developing under ERISA in the 401(k) cases. Consider the position of Employee X who participated in a 401(k) plan at her employer, Company A. ERISA prohibits fiduciaries from making deceptive statements in connection with an employee benefit plan.

Assume a plan fiduciary made untruthful negative statements about Company A's short term prospects in order to keep the stock price low because of a contemplated repurchase program. If, because of the fraudulent statement, Employee X did not purchase Company A securities that X otherwise would have bought through the 401(k) plan, X would have a claim for breach of fiduciary duty under ERISA. In contrast, assume X alleges that, but for the fraud, she would have purchased company securities through her private brokerage account. In the latter situation, Employee X has no right to bring a securities fraud claim under federal law because the relevant provision, section 10b of the '34 Act requires the existence of an actual securities sale or purchase.³⁴² Similarly, if the fraud prevented a non-employee from purchasing Company A securities, the defrauded investor would have no standing to bring a claim under section 10b.

3. Scierter Standards

Even if a misrepresentation or omission results in the purchase or sale of a security so that an investor would meet that prong of the section 10b standing requirement, that provision still imposes a significant scierter requirement. The circuit courts of appeals require a section 10(b) plaintiff to prove at least recklessness on the part of each defendant.³⁴³ When an employee brings the misrepresentation or omission claim as an ERISA breach of fiduciary duty claim, however, the plaintiff need only prove the existence of a misrepresentation or omission made by the fiduciary. The ERISA fiduciary standards follow traditional trust law and typically there is no scierter requirement.³⁴⁴ Again, then, the success of a misrepresentation or omission suit may depend entirely on whether a plaintiff is bringing the claim based on his participation in an employer-sponsored plan and the fiduciary duties he is owed under that plan or because of actions connected with a purchase or sale of employer securities that is not related to a benefit plan.

4. Remedial Considerations

In all of the instances considered thus far employees who assert rights in their role as benefit plan participants or beneficiaries enjoy more protection under ERISA than they would if they were to stand in the shoes of the prototypical investor and bring federal securities law claims based on the same or equivalent actions. In decided contrast, although participants and beneficiaries may enjoy superior standing rights and not have to make a showing of scierter, even if the participants or beneficiaries win an ERISA-based fiduciary claim, they may face substantial difficulties when it comes to recovery. The only option for an employee with a valid fiduciary breach claim who cannot claim relief flowing to the plan, will be to attempt to state a claim for relief under ERISA's catch-all remedial provision.³⁴⁵ In cases other than fiduciary breach cases, the Supreme Court, however, has construed that provision, which permits "other equitable relief"³⁴⁶ to include only traditional equitable relief and to exclude money damages.

Because courts of equity developed the concept of fiduciary obligation as well as all the traditional remedies flowing from breach of those obligations, there are good reasons to believe that the limitation on relief to traditional equitable relief should not preclude recovery in ERISA fiduciary breach cases. However, if the courts do not make this distinction, plaintiffs would most likely need to state a claim for traditional equitable restitution. That would require a showing that the defendants hold an identifiable res that in good conscience belongs to the plaintiffs.³⁴⁷ It is difficult in most circumstances, other than perhaps situations where they have traded on informational advantages, to contemplate a situation where the breaching fiduciaries would be in possession of an identifiable sum of money or securities that equity would view as, in good conscience, belonging to the plaintiffs. For violation of section 10b-5, in contrast, the '34 Act provides a prevailing plaintiff with a choice between rescission and damages with damages often being calculated as out-of-pocket damages.³⁴⁸

B. Enforcement Anomalies and Analogs – State Corporate Law and ERISA

As is true of federal securities law and ERISA, the interaction of state corporate law and ERISA offers some intriguing insights for courts and policy makers confronting the liability of officers and directors for employee investments in company stock. Unlike securities law though, both state corporate law and ERISA are grounded in fiduciary duty. As is evident from the above discussion, the corporate law fiduciary standards evolved differently from the ERISA standards. Yet, in some ways, the standards are analogous. Both state corporate law and ERISA rely largely on the principles of prudence, care, and loyalty. For these reasons, existing principles of state corporate law may be particularly valuable in establishing the scope of director and officer duties with respect to employee investments in company stock.

1. Affirmative Decisions by Corporate Officers and Directors

Corporate law is highly deferential to the judgment of corporate officers and directors in cases where shareholders allege that a bad business decision caused them harm. Provided that the corporate officials utilized a reasonable process, obtained all reasonably available information, acted in good faith and there was no evidence of a conflict of interest, the business decision is generally not questioned by the courts. This doctrine seems analogous to the settlor doctrine that has developed in ERISA jurisprudence and is highly protective of corporate actors. In fact, to go one step further, to the extent that officers and directors do not have ERISA fiduciary obligations for decisions reflected in the terms of plan documents, those decisions could be challenged only under the corporate law standards. As such then, an affirmative decision by a board of directors to approve 401(k) plan terms that require participants to have the option of investing their discretionary contributions in company stock would be protected by the business judgment doctrine.³⁴⁹

Similarly, where a benefit plan allows but does not mandate company stock as an investment option or source of a company's matching contributions, courts have developed an abuse of discretion standard under ERISA to evaluate whether a plan fiduciary had a duty to review the continued prudence of investments in employer stock.³⁵⁰ This too results in a standard that is very protective of the decision making of corporate officers and directors.

One might ask, however, whether high levels of deference make sense in both the general business context and in the 401(k) context. One explanation offered for use of the deferential business judgment standard in state corporate law is to ensure that the legal standards do not cause corporate officers and directors to become too risk averse.³⁵¹ Concern with risk aversion also should play a role in developing the standards governing officer and director conduct in evaluating whether to offer company stock as an investment option or use it to make the company's matching contribution. After all, in theory corporate officers and directors might be held liable for fiduciary breach if they decide not to utilize company securities in this way and the stock performs well.³⁵² On the other hand, corporate directors and indirectly corporate officers are selected and elected by the stockholders for their business acumen and can be removed by the stockholders if their business expertise is inadequate. Courts, then, should be reluctant to second guess the general business decisions of a board. Employees, in contrast, have no significant control other than to the extent of their company stock ownership over the identities of those individuals who are making decisions on the use of company stock in employee benefit plans.

While the deferential business judgment rule is the standard in evaluating board decisions, there are situations in corporate law where the courts more closely scrutinize the decision of the board of directors. These situations generally involve potential conflicts of interest implicating the duty of loyalty. For example, in the body of case law that has developed in the hostile takeover arena, the Delaware courts have shown that they are willing to scrutinize the decision to resist the takeover attempt more closely than an ordinary business decision. In this context, the courts are willing to evaluate the reasonableness of the antitakeover device and make a determination regarding whether the device was reasonable in relation to the threat the takeover posed to the corporation.³⁵³ The difference between the analysis in the antitakeover cases and cases involving other business decisions is that the courts will second-guess the reasonableness of the directors' decision to employ the antitakeover device. Further, the courts are even willing to order the directors to conduct an auction for the company where they find a sale or break-up of the company is inevitable.³⁵⁴ In these cases, it appears that the conflict of interest inherent in deciding whether to sell a company is the driving force behind the courts' stricter scrutiny of the transactions.

Perhaps a similar enhanced level of scrutiny would be useful in evaluating director and officer decisions with respect to company stock. That is, in some instances it may be appropriate to be more deferential to the decisions of a fiduciary, along the lines of a corporate law business judgment rule analysis. This deferential standard might apply in instances where the decisions of the ERISA fiduciary are made in good faith, after obtaining all reasonably available information, and where conflicts of interest are minimal. For example, where the fiduciary selects investment options that have no affiliation with the employer, such as a mutual fund family that has no other relationships with the company, the fiduciary would be entitled to deference for that decision so long as it was made in good faith and on a reasonably informed basis. However, in situations that present inherent conflicts of interest, such as decisions involving the use of company

stock, stricter scrutiny may be appropriate. An analysis along the lines of the corporate law antitakeover cases, where the courts evaluate the reasonableness of the ERISA fiduciary's decisions, may be in order.

Alternatively, legal standards may be developed to encourage ERISA fiduciaries to minimize their conflicts of interest when they are making decisions about the use of company stock in 401(k) plans. To reduce the existence of conflicts for purposes of the state corporate law standards, boards sometimes delegate decision making to a subset of directors who do not have a conflict of interest in the transaction under consideration. In other instances, a board of directors will address a conflict of interest by hiring an independent expert to make a particular decision or to make a recommendation on the decision in question. Similarly, corporate directors and officers who confront decisions about the use of company stock in employer-sponsored plans might negate or at least lessen the conflicts of interest inherent in those decisions by hiring an independent expert to make or to assist in making the decisions.

2. Oversight Obligations by Corporate Officers and Directors

The framework of analysis developed in state corporate law to evaluate the oversight obligations of corporate officers and directors also may offer valuable insights for the company stock cases. Courts have struggled and come to opposing conclusions on whether corporate officers and directors have responsibility under ERISA to appoint and monitor plan fiduciaries.³⁵⁵ Even in *Enron*, where the court determined that those who appoint plan fiduciaries have the "duty to insure that the selected fiduciaries in turn complied with their fiduciary duties,"³⁵⁶ application of the standard is difficult. At another point the judge recognized that some courts have placed restrictions on the oversight responsibilities of corporate officers and directors. Specifically, she cited a case where the court had held that directors "do not breach duties in the absence of 'notice of possible misadventure by their appointees.'"³⁵⁷ Thus, even when courts determine that officers and directors face liability for failure to monitor the fiduciaries they appoint, it is unclear what standards will be used to evaluate compliance with the monitoring obligation.

It may be worthwhile in such cases for the courts to consider a *Caremark*-like analysis. Under such an approach, if a claim alleges breach of duty due to failure to monitor the actions of others, the court would likely consider whether the defendants either knew or should have known that the violation was occurring; whether a reasonable compliance system was in place; and if there was not a compliance system, whether one should have been implemented. Unlike the standard quoted by the *Enron* court, which seems to require actual notice of wrongdoing, using a "should have known" approach does not permit officers and directors to take the ostrich approach of burying their heads in the sand and avoiding knowledge of misadventure.

C. A Final Challenge in Rationalizing the Legal Regimes

The interaction of federal securities law, ERISA, and state corporate law requires courts and policy makers to be particularly sensitive in balancing these three sources of law. In particular, we have articulated rational arguments in favor of imposing significant affirmative disclosure obligations under ERISA on officers and directors. In addition, we suggested use of an enhanced level of scrutiny for decisions involving the use of employer stock in company-sponsored plans. We also believe it would be appropriate to impose a monitoring obligation on fiduciaries together with a "knew or should have known" approach to evaluating whether officers and directors fulfill their monitoring duties.

The standards we suggest should encourage officers and directors to make themselves aware of issues regarding the use of company stock in employer-sponsored plans. However, once the officers and directors become aware of significant issues that a reasonable employee would want to know when deciding whether to purchase or sell company stock, a strong approach to affirmative disclosure obligations under ERISA would require the dissemination of that information to the employees. Securities law, in turn, would require the concurrent dissemination to the public markets of any information that is both material and nonpublic. As a result, although it may not be obvious at first glance, even the determination of whether officers and directors have monitoring obligations over benefit plan fiduciaries may have important implications for federal securities law. The scope of affirmative disclosure requirements that will incide upon issuers of securities may no longer be determined exclusively by the limited annual, quarterly, and other standards of the federal securities laws. Instead, the obligations of corporate benefit plan fiduciaries, as informed by state corporate law fiduciary principles, may have significant effects on the future of a corporation's public disclosure obligations.

V. Conclusion

The current corporate scandals are presenting the courts with some very difficult issues regarding losses suffered by employees from purchases of company stock made through employer-sponsored benefit plans. The decisions in these cases will not only affect the development of ERISA jurisprudence, but have the potential of creating unintended consequences in securities law. It thus becomes incumbent on the courts as they define the contours of fiduciary standards in these cases to carefully consider the underlying policies of both ERISA and the federal securities law regimes, regardless

of whether a claim is cast as a section 10b claim under the '34 Act or an ERISA claim. Otherwise, their decisions may create serious anomalies concerning disclosure rules and fiduciary obligations.

Although continually evolving, state corporate law may well provide a model for the courts to consider when deciding these types of federal claims. The fiduciary obligations imposed by ERISA and state corporate law are, in each regime, grounded in traditional trust law. State corporate law has the advantage of a long history of adaptation to the unique considerations inherent in determining the obligations of directors and officers to corporate shareholders. We do not argue that ERISA fiduciary obligation should mirror the corporate standards. However, as courts take up the new challenges presented by the employer stock cases, they should not ignore the fiduciary principles developed under state corporate law. In Warren Buffett's words: "[T]he rearview mirror is always clearer than the windshield."³⁵⁸

FOOTNOTES

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⁴ Andrew Countryman, *Oversight Chief Says Trust Up to Auditors*, CHI. TRIBUNE, Feb. 26, 2004, at C1 ("Congress . . . is 'really responsive to th[e] fury at the level of the average American.'").

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⁸ Sandra Guy, *Allianz Jumping Into Market for Officer Liability Insurance*, CHI. SUN-TIMES, Jan. 7, 2003, at Fin. p. 45 ("The rates and deductibles that companies pay for liability insurance for their officers and directors have skyrocketed in the last few years because of book-cooking scandals.").

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¹⁰ Jonathan D. Glater, *From Investor Fury, A Legal Bandwagon*, N.Y. TIMES, Sept. 15, 2002, at sec. 3 col. 1 p. 1.

¹¹ Complaint for ERISA Violations, *Chao v. Enron Corp.*, S.D. Tex. (2003).

¹² Employee Retirement Income Security Act (ERISA), of 1974 ' ' 1-4402, 29 U.S.C. ' ' 1001-1461 (2000).

¹³ Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968 (2000).

¹⁴ *In Re Enron Corporation Securities, Derivative & "ERISA" Litigation*, 284 F. Supp. 2d 511 (S.D. Tex. 2003).

¹⁵ *Id.*

¹⁶ A stock purchase or option plan allows an employee to purchase the employer's securities either at current market rates or at a set price (respectively) while a 401(k) plan provides for tax-favored individual accounts. Contributions to 401(k) plans may be made by employers and/or employees and employer securities may be an investment option or some contributions, particularly what is known as employer matching contributions, may be invested automatically in employer securities. For a discussion of these plans and defined contribution (DC) plans more generally, see Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 4 (2002).

¹⁷ *Id.* at 11-1.

¹⁸ 15 U.S.C. § 77a *et seq.*

¹⁹ 15 U.S.C. § 78a *et seq.*

²⁰ LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION § 2(B)(1) (4th ed. 2003).

²¹ *Id.*

²² *Id.*

²³ Securities Act Release No. 33-6281, at Part 1-B.

²⁴ Securities Act Release No. 33-6188, at Part III-B(1); Securities Act Release No. 33-4790.

²⁵ LOSS & SELIGMAN, *supra* note 20, at § 1(D)(3).
²⁶ *Id.*
²⁷ LOSS & SELIGMAN, *supra* note 20, at § 9(B)(5).
²⁸ 15 U.S.C. § 78j(b) (2000).
²⁹ Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).
³⁰ Ernst & Ernst v. Hockfelder, 425 U.S. 185 (1976).
³¹ LOSS & SELIGMAN, *supra* at 20.
³² Blue Chip Stamps v. Maynard Drug Stores, 421 U.S. 723 (1975).
³³ 17 C.F.R. § 243.100 *et seq.*
³⁴ It also regulates the communications of investor relations professionals and other issuer representatives who regularly interact with security holders or securities market professionals. *Id.* at § 243.100(b).
³⁵ *Id.*
³⁶ LOSS & SELIGMAN, *supra* note 20, at § 9(B)(9)(a).
³⁷ *See supra* text accompanying note 21.
³⁸ '33 Act, 15 U.S.C. §§ 11-12 (2000).
³⁹ *Id.*
⁴⁰ 40 S.E.C. 907 (1961).
⁴¹ *Id.* at 908.
⁴² Dirks v. SEC, 463 U.S. 646(1983); Chiarella v. United States, 445 U.S. 222 (1980).
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⁴⁴ United States v. O'Hagan, 521 U.S. 642 (1997).
⁴⁵ Kirstin Downey, *Restitution Sought From Enron Officials*, WASH. POST, June 27, 2003, at E01.
⁴⁶ *In re Enron Corp. Securities, Derivative & "ERISA" Litig.*, 28 F. Supp. 2d 511 (S.D. Tex. 2003).
⁴⁷ Complaint for ERISA Violations, Chao v. Enron Corp., S.D. Tex. (2003).
⁴⁸ Secretary of Labor Elaine L. Chao Announces Settlements Restoring at Least \$66.5 Million to Enron Retirement Plans, U.S. Department of Labor Press Release, Office of Public Affairs, Washington, D.C., May 13, 2004.
⁴⁹ *See infra* Part IV.
⁵⁰ ERISA § 402(a), 29 U.S.C. § 1102(a) (2000).
⁵¹ ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (2000).
⁵² ERISA § 3(7), 29 U.S.C. § 1002(7) (2000).
⁵³ Confer v. Custom Engineering Co., 952 F.2d 34, 37 (3d Cir. 1991).
⁵⁴ *Id.* at 38.
⁵⁵ *See id.* at 35 ("Defendants . . . own 94 per cent of Custom Engineering").
⁵⁶ *Id.* at 37.
⁵⁷ *See id.* The court actually refers only to discretion over plan administration as giving rise to fiduciary status. That language is understandable given the context of the case, but, given the relevant statutory language on functional fiduciary status, the court's reasoning would seem to extend to discretionary functions that relate to plan management or assets. It also would seem to apply to investment advice provided for a fee though that is rarely within the scope of duties of a corporate director or officer.
⁵⁸ *Id.*
⁵⁹ No. H-02-2051, 2004 U.S. Dist LEXIS 1450 (S.D. Tex. Jan. 20, 2004).
⁶⁰ 51 F.3d 1449, 1461 (9th Cir. 1994); *see also* Bannistor v. Ullman, 287 F.3d 394, 403-06 (5th Cir. 2002) (rejecting the Third Circuit's approach and determining that corporate officers were liable as fiduciaries).
⁶¹ 51 F.3d at 1459.
⁶² *Id.* at 1461.
⁶³ *Id.* at 1460.
⁶⁴ ERISA § 410; 29 U.S.C. § 1110 (2000).
⁶⁵ 51 F.3d at 1460.
⁶⁶ *Id.* at 1460-61.
⁶⁷ Stewart v. Thorpe Holding Co. Profit Sharing Plan, 207 F.3d 1143, 1156-57 (9th Cir. 2000).
⁶⁸ *Id.* at 1156.
⁶⁹ 284 F. Supp. 2d 511 (S.D. Tex. 2003).
⁷⁰ *Id.* at 531-537.
⁷¹ *Id.* at 569.
⁷² *Id.* (quoting Bell v. Executive Committee of United Food and Commercial Workers Pension Plan for Employees, 191 F. Supp. 2d 10, 15 (D.D.C 2002)).

⁷³ *Mertens v. Hewitt*, 508 U.S. 248, 262 (1993) (ERISA, however, defines "fiduciary" not in terms of formal trusteeship, but in functional terms of control and authority over the plan, see 29 U.S.C. § 1002(21)(A), thus expanding the universe of persons subject to fiduciary duties -- and to damages -- under § 409(a).").

⁷⁴ See *supra* text accompanying notes 63-64.

⁷⁵ The court in *Confer* states that corporate actors who act improperly vis-à-vis the company's benefit plan may breach an obligation owed to the corporation under state law. 952 F.2d 34, 38 (3d Cir. 1991). Similarly, one could argue that an individual who refuses to take appropriate discretionary actions with respect to a benefit plan also breaches a state law fiduciary obligation owed to the company and its owners. Such a situation raises interesting questions regarding the application of ERISA's preemptive force, however, those questions are beyond the scope of this article.

⁷⁶ *In re Electronic Data Systems Corp. ERISA Litigation*, 305 F. Supp. 2d 658 (E.D. Tex. 2004); *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 284 F. Supp. 2d 511, 543 (S.D. Tex. 2003).

⁷⁷ *In re Electronic Data Systems Corp. ERISA Litigation*, 305 F. Supp. 2d at 668.

⁷⁸ *Id.* at 661-62.

⁷⁹ *Id.* at 662.

⁸⁰ *Id.*

⁸¹ *Id.* at 666.

⁸² *Id.*

⁸³ *Id.* at 666-67.

⁸⁴ *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999) (settlor doctrine applied to contributory retirement plan); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996) (settlor doctrine applied to noncontributory retirement plan); *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73 (1995) (settlor doctrine applied to retiree health care plan).

⁸⁵ *Hughes*, 525 U.S. at 443.

⁸⁶ *Id.* at 444.

⁸⁷ *Id.*

⁸⁸ See CCH Defined Benefit Pension Plan, ¶ 30,065, reprinted in PETER J. WIEDENBECK, & RUSSELL K. OSGOOD, CASES AND MATERIALS ON EMPLOYEE BENEFITS (1996) (setting forth standardized sample plans).

⁸⁹ See *infra* text accompanying notes 106-28 for a discussion of the standards.

⁹⁰ See *Varity Corp. v. Howe*, 516 U.S. 489 (1996).

⁹¹ Whether there is any limit to the type of change that can be accomplished through a plan amendment and, thus, made without application of ERISA's fiduciary standards, remains an open question. In *Hughes*, the plaintiffs argued that the plan amendment constituted a sham transaction. The Court implied that a sham transaction might be sufficient to "implicate a fiduciary duty," but had not occurred in that case. 525 U.S. at 445.

⁹² 516 U.S. 489 (1996).

⁹³ *Id.* at 504.

⁹⁴ *Id.* at 503.

⁹⁵ *Id.*

⁹⁶ See, e.g., *Crowley v. Corning*, No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758 (W.D.N.Y. Jan. 14, 2004) (relying on the plan's language which did not grant the defendants any discretion over the role of Corning stock in the plan).

⁹⁷ *Id.* at *12.

⁹⁸ *Crowley v. Corning, Inc.*, 234 F. Supp. 2d 222, 225 (W.D.N.Y. 2002).

⁹⁹ 2004 U.S. Dist. Lexis 758, at *18-19.

¹⁰⁰ *Corning I*, 234 F. Supp. at 228-30.

¹⁰¹ 62 F.3d 553, 571 (3rd Cir. 1995).

¹⁰² 263 F. Supp. 2d 745, 764 (S.D.N.Y. 2003).

¹⁰³ 2004 U.S. Dist. Lexis 758, at *20.

¹⁰⁴ *Id.* at *5-6.

¹⁰⁵ *Id.* at *23.

¹⁰⁶ Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105 (1988).

¹⁰⁷ ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (2000).

¹⁰⁸ Fischel & Langbein, *supra* note 1105, at 1138-42.

¹⁰⁹ Dana M. Muir, *Fiduciary Status As an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391, 414 (2000).

¹¹⁰ *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2nd Cir. 1982).

¹¹¹ *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 445 (1999) (quoting *Lockheed Corp. v. Spink*, 517 U.S. 882, 893 (1996)).

¹¹² ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (2000).

¹¹³ Mark Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 24 (1991) (“ERISA enhances the standard of care for plan operators to that of an expert . . .); Note, Yolanda Sayles, *ERISA Section 404(c) Plan Fees and Expenses: Is there an Affirmative Fiduciary Duty to Disclose?*, 25 WM. MITCHELL L. REV. 1461, 1488 (1999) (stating this rule is “commonly referred to as the . . . prudent expert rule.”).

¹¹⁴ Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. MICH. J.L. REF. 469, 483 (2001) (quoting *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983) (“a pure heart and an empty head are not enough’ . . .”).

¹¹⁵ Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, n.100 (2000) (“Fiduciaries . . . are apparently obligated to exercise only procedural prudence . . .”); Jayne Elizabeth Zanglein, *Protecting Retirees While Encouraging Economically Targeted Investments*, 5 KAN. J.L. & PUB. POL’Y 47, 52 (1996) (“Prudence is measured in terms of procedural prudence.”).

¹¹⁶ ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (2000).

¹¹⁷ Robert A. Levy, *The Prudent Investor Rule: Theories and Evidence*, 1 GEO. MASON L. REV. 1, 4 (1994).

¹¹⁸ Compare Richard H. Koppes & Maureen L. Reilly, *An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor an Index Fund Through Relationship Investing*, 20 IOWA J. CORP. L. 414, 436-37 (1995) (“The DOL was quick to recognize modern portfolio theory as an appropriate measure of prudent investment.”); Note, Bradley P. Rothman, *401(k) Plans in the Wake of the Enron Debacle*, 54 FLA. L. REV. 921, 934 (2002) (“Generally, prudent diversification entails using modern portfolio theory . . .”) with Deborah M. Weiss & Marc A. Sgaraglino, *Prudent Risks for Anxious Workers*, 1996 WIS. L. REV. 1175, 1177 (1996) (“[ERISA’s] fiduciary rules acknowledge portfolio theory, but almost wholly fail to incorporate the insights of modern portfolio theory.”).

¹¹⁹ *Laborers Nat’l Pension Fund v. N. Trust Quantitative Advisors, Inc.*, 173 F.3d 313, 317 (5th Cir. 1999); *Meyer v. Berkshire Life Ins. Co.*, 250 F. Supp 2d 544, 553 (D. Md. 2003).

¹²⁰ ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (2000).

¹²¹ ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (2000).

¹²² Edward E. Bintz, *Fiduciary Responsibility Under ERISA: Is There Ever a Fiduciary Duty to Disclose?*, 54 U. PITT. L. REV. 979, 980 (1993).

¹²³ Compare ERISA § 103, 29 U.S.C. § 1023 (2000) (requiring annual reports) with 15 U.S.C. § 78m (2000) (requiring filing of reports as required by the SEC).

¹²⁴ Compare 29 C.F.R. § 2520.103-1 (stating requirements for plan annual report) with 17 C.F.R. § 240-15d-11 (regarding annual reports required by the SEC).

¹²⁵ Bryan L. Clobes, *In the Wake of Varsity Corp. v. Howe: An Affirmative Fiduciary Duty to Disclose Under ERISA*, 9 DEPAUL BUS. L.J. 221, 226-27 (1997) (“The recent trend favors imposing upon fiduciaries the common law rule requiring them to disclose material information concerning existing plans and benefits when they know that silence might be harmful.”); Comment, Joseph E. Czerniawski, *Bins v. Exxon: Affirmative Duties to Disclose Proposed Benefit Changes in the Absence of Employee Inquiry*, 76 NOTRE DAME L. REV. 783, 808 (2001) (“There has been considerable disagreement among the lower courts dealing with disclosure of proposed benefit changes, but there has been a trend towards a ‘serious consideration’ test as triggering fiduciary disclosure duties in these cases.”); Note, Melissa Elaine Stover, *Maintaining ERISA’s Balance: The Fundamental Business Decision v. The Affirmative Fiduciary Duty to Disclose Proposed Changes*, 58 WASH. & LEE L. REV. 689, 691 (2001) (stating “the current trend in the federal courts [is] to expand a plan administrator’s disclosure duties by emphasizing her fiduciary obligation to provide material information to plan participants.”).

¹²⁶ Clobes, *supra* note 125, at 227.

¹²⁷ *Id.*

¹²⁸ *Id.* at 226-27 (“The recent trend favors imposing upon fiduciaries the common law rule requiring them to disclose material information concerning existing plans and benefits when they know that silence might be harmful.”).

¹²⁹ See *supra* text accompanying note 45.

¹³⁰ *In re Enron Corp. Securities, Derivative & “ERISA” Litigation*, 284 F. Supp. 2d 511, 531-37 (S.D. Tex. 2003).

¹³¹ *Id.*

¹³² *Id.* at 537.

¹³³ *Id.* at 682-84.

¹³⁴ *Hill v. BellSouth Corp.*, No 1:02-CV-2440-JOF, 2004 U.S. Dist. LEXIS 6045, at *8 (N.D. Ga. Mar. 30, 2004) (alleging the company’s incentive plan for officers caused the officer-fiduciaries to have a conflict of interest).

¹³⁵ *In Re Electronic Data Systems Corp. “ERISA” Litigation*, 305 F. Supp 2d 658, 673 (E.D. Tex. 2004) (alleging fiduciaries’ obligation to protect corporation and act on behalf of plan participants and beneficiaries created a conflict of interest).

¹³⁶ *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2nd Cir. 1982).

¹³⁷ See, e.g., *Hill*, 2004 U.S. Dist. LEXIS 6045, at *21 (denying motion to dismiss fiduciary breach claim predicated on conflict of interest); *In re Electronic Data Systems Corp. “ERISA” Litigation*, 305 F. Supp. 658, 673-74 (same).

¹³⁸ 263 F. Supp. 2d 745, 763 (S.D.N.Y. 2003).

¹³⁹ *Id.* at 764.

¹⁴⁰ IRC § 4975(e)(7) (2000).

¹⁴¹ Kuper v. Lovenko, 66 F.3d 1447 (6th Cir. 1995); Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).

¹⁴² Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995) ((quoting RESTATEMENT (SECOND) OF TRUSTS § 227 comment g. (1959)).

¹⁴³ *WorldCom*, 263 F. Supp. 2d at 764-65; Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758, at *20-23 (W.D.N.Y. Jan. 14, 2004).

¹⁴⁴ 62 F.3d at 571-72.

¹⁴⁵ Colleen Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 11 (2000).

¹⁴⁶ Jefferson, *supra* note 115, at 627.

¹⁴⁷ Pamela Perun & C. Eugene Steuerle, From Fiduciary to Facilitator: Rethinking the Role of Employers in Defined Contribution Plans, The Urban Institute 13 (Dec. 5, 2000) (unpublished manuscript, on file with authors), *available at* <http://www.planetnow.com/pamelawork/facilitator.pdf>.

¹⁴⁸ 29 C.F.R. § 2550.404(c)-1 (1992).

¹⁴⁹ Sharon Reece, *Enron: The Final Straw & How to Build Pensions of Brick*, 41 DUQ. L. REV. 69, 85 (2002).

¹⁵⁰ In re: Reliant Energy ERISA Litigation, No. H-02-2051, 2004 U.S. Dist. LEXIS 1450, at *62-64 (S.D. Tex. Jan. 27, 2004); In re Enron Corp. Securities, Derivative & “ERISA” Litig., 284 F. Supp. 2d 511, 574-78 (S.D. Tex. 2003); Rankin v. Rots, 278 F. Supp. 853, 868-69 (E.D. Mich. 2003) (stating that K-Mart fiduciaries argue § 404(c) protects them from liability).

¹⁵¹ *In re: Reliant Energy ERISA Litigation*, 2004 U.S. Dist. LEXIS 1450, at *63 n.57 (“REI’s counsel conceded at oral argument on this motion [to dismiss] that because Section 404(c) provides an affirmative defense to liability, it likely is not a proper grounds on which to grant Rule 12(b)(6) dismissal.”); *Rankin*, 278 F. Supp. at 872 (“Whether or not section 404(c) applies is not a question on a motion to dismiss. Section 404(c) provides defendants with a defense to liability; it does not mean that Rankin has failed to make out a claim against them.”)

¹⁵² *In re Enron Corp. Securities, Derivative & “ERISA” Litig.*, 284 F. Supp. 2d at 574.

¹⁵³ *Id.* at 577.

¹⁵⁴ *Id.* at 578.

¹⁵⁵ *See, e.g., In re: Reliant Energy ERISA Litigation*, 2004 U.S. Dist. LEXIS 1450, at *62 (“Plaintiff has properly alleged that Defendants have not complied with § 404(c)”).

¹⁵⁶ In re Enron Corp. Securities, Derivative & “ERISA” Litig., 284 F. Supp. 2d at 578.

¹⁵⁷ *Id.* at 552 (“A person or entity that has the power to appoint, retain and/or remove a plan fiduciary from his position has discretionary authority or control over the management or administration of a plan and is a fiduciary to the extent that he or it exercises that power.”).

¹⁵⁸ *Id.* at 534, n.5.

¹⁵⁹ 278 F. Supp. 2d 853, 863 (E.D. Mich. 2003).

¹⁶⁰ 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003).

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ For a discussion of the settlor doctrine, see *supra* text accompanying notes 84-105.

¹⁶⁴ 263 F. Supp. 2d at 761.

¹⁶⁵ Dana M. Muir, *Contemporary Social Policy Analysis and Employee Benefit Programs: Boomers, Benefits, and Bargains*, 54 WASH. & LEE L. REV. 1351, 1363 (1997).

¹⁶⁶ *Infra* Part III.

¹⁶⁷ *Infra* Part IV.

¹⁶⁸ 263 F. Supp. 2d at 760.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ 284 F. Supp. 2d 511, 554 (S.D. Tex. 2003).

¹⁷² *Id.* at 556.

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 657.

¹⁷⁵ *Id.* at 658.

¹⁷⁶ *See supra* text accompanying notes 26-32.

¹⁷⁷ For a discussion of the history and benefits of employee ownership, see Dana M. Muir, *Groundings of Voice in Employee Rights*, 36 VAND. J. TRANSNAT’L L. 485, 489-94 (2003).

¹⁷⁸ Rankin v. Rots, 278 F. Supp. 2d 853, 872 (E.D. Mich. 2003).

¹⁷⁹ Hull v. Policy Management Sys. Corp., No. 3:00-778-17, 2001 U.S. Dist. LEXIS 22343, at *21 (D. S.C. Feb. 9, 2001).

¹⁸⁰ No. C00-20030 RMW, 2002, U.S. Dist. LEXIS 19473, at *21 (N.D. Cal. Sept. 30, 2002).

¹⁸¹ 278 F. Supp. 2d at 876-77.

¹⁸² 263 F. Supp. 2d 745, 765-67 (S.D.N.Y. 2003).

¹⁸³ 284 F. Supp. 2d at 563-67.

¹⁸⁴ *Id.* at 566-67.

¹⁸⁵ Dana M. Muir, *ERISA and Investment Issues*, 65 OHIO ST. L.J. 199, 223-225 (2004).

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* at 230-235.

¹⁸⁸ 122 S. Ct. 708 (2002).

¹⁸⁹ ERISA §§ 502(a)(1)(B), 29 U.S.C. §§ 1132(a)(1)(B) (2000).

¹⁹⁰ RESTATEMENT OF RESTITUTION § 1 (1937).

¹⁹¹ 122 S. Ct. at 714.

¹⁹² Varsity v. Howe, 516 U.S. 489, 515 (1996).

¹⁹³ 122 S. Ct. at 714 (quoting *Reich v. Continental Casualty Co.*, 33 F.3d 754, 756 (7th Cir. 1994)).

¹⁹⁴ 1 D. DOBBS, LAW OF REMEDIES § 2.3(2) (2d ed. 1993).

¹⁹⁵ *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *Chambers v. Beaver-Advance Corp.*, 392 Pa. 481 486 (1958); *Dennis v. Copelin*, 660 So. 2d 556, 560 (La. App. 1996); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 BOSTON COL. L. REV. 595, 595 (1997). *See generally* J.C. SHEPHERD, THE LAW OF FIDUCIARIES (1981); WILLIAM E. KNEPPER ET AL., LIABILITY OF CORPORATE OFFICERS AND DIRECTORS §1.07 (9th ed. 2003).

¹⁹⁶ *See* sources cited *infra* notes 241-309 and 322-32 and accompanying text for a discussion of the duties of care and loyalty. One of the earliest cases discussing the duty of care in the United States is *Percy v. Millaudon*, 9 Mart. (n.s.) 68, 74-75 (La. 1829).

¹⁹⁷ *See* sources cited *infra* notes 310-21 and accompanying text for a discussion of the obligation of good faith.

¹⁹⁸ *See supra* text accompanying notes 106-21.

¹⁹⁹ *See, e.g.*, Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333 (2002); Edward Roch & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 651 (2002); Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971, 973 (1994); L.S. Sealy, *Fiduciary Relationships*, CAMBRIDGE L. J. 69, 70 (1962).

²⁰⁰ LAWRENCE FRIEDMAN, HISTORY OF AMERICAN LAW (2d ed. 1985).

²⁰¹ *See* SHEPHERD, *supra* note 195, at 98.

²⁰² *See* Sealy, *supra* note 199, at 71-72 (“The word fiduciary (which earlier had received very little judicial support) was adopted to describe these situations which fell short of the now strictly defined trust.”) (footnote omitted). *See also* Walsh, *supra* note 199, at 334.

²⁰³ *See* Horsey, *supra* note 199, at 974; Walsh, *supra* note 199, at 334.

²⁰⁴ ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW §1.02-.03 (1999).

²⁰⁵ *Id.*

²⁰⁶ RESTATEMENT OF TRUSTS §174; Rock & Wachter, *supra* note 199, at 653-54.

²⁰⁷ RESTATEMENT OF TRUSTS, Comment to §174.

²⁰⁸ *Id.* at §205.

²⁰⁹ 2 Atk. 400, 405, 26 Eng. Rep. 642 (Ch. 1742) (the board were “most properly agents to those who employ them in this trust and superintend the affairs of the corporation.”). *See also* Sealy, *supra* note 199.

²¹⁰ *See also*, Horsey, *supra* note 199, at 973; Rock & Wachter, *supra* note 199, at 656.

²¹¹ *Sutton*, 2 Atk. at 406, 26 Eng. Rep. at 645.

²¹² 82 N.Y. 65 (1880).

²¹³ *Id.* at 74.

²¹⁴ *Id.*

²¹⁵ 141 U.S.132 (1891).

²¹⁶ *Id.* at 152.

²¹⁷ 118 A. 1 (Del. 1922).

²¹⁸ *Id.* at 3.

²¹⁹ 132 A. 442 (Del. Ch. 1926), *aff’d*, 140 A.2d 264 (Del. 1927).

²²⁰ *Id.* at 446.

²²¹ *Id.* at 447.

²²² *See, e.g.*, *See Briggs v. Spaulding*, 141 U.S. 132, 152 (1891) (stating “the degree of care to which these defendants were bound is that which ordinarily prudent and diligent men would exercise under similar circumstances...); *Charitable Corp. v.*

Sutton 26 Eng. Rep. 642, 645 (Ch. 1742) (holding that "by accepting of a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence."). See also Rock & Wachter, *supra* note 199, at 655; Krishnan Chittur, *The Corporate Director's Standard of Care: Past, Present and Future*, 10 DEL. J. CORP. L. 505, 507-08 (1985) ("Conceivably the rule's foundation is in tort law, in that directors' decisions were protected as long as they behaved reasonably. The rule thus incorporates the 'reasonable man' standard to determine negligence . . .").

²²³ Joseph W. Bishop, Jr., *Sitting Duck and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L. J. 1078, 1099-1100 (1968). Bishop found only four cases in which directors of industrial corporations had been held liable to a standard of negligence.

²²⁴ The duty of care is defined by statute in a majority of states. See, e.g., ALASKA STAT. § 10.06.450 (Michie 2004); ARIZ. REV. STAT. § 10-830 (2004); CAL. CORP. CODE tit. 1 § 309 (Deering 2004); CONN. GEN. STAT. § 33-756 (2003); FLA. STAT. ANN. § 607.0830 (West 2004); GA. CODE ANN. § 14-2-830 (2002); HAW. REV. STAT. ANN. § 414-221 (Michie 2003); IDAHO CODE § 30-1-830 (Michie 2004); 805 ILL. COMP. STAT. 5/8.05 (1983); IND. CODE ANN. § 23-1-31-1 (Michie 2004); IOWA CODE § 490.830 (2003); KY. REV. STAT. ANN. § 271B.8-300 (Michie 2003); LA. REV. STAT. ANN. § 12.91 (West 2004); ME. REV. STAT. ANN. tit. 13-C § 831 (West 2003); MD. CODE ANN., CORPS. & ASS'NS § 2-405.1 (2003); MASS. GEN. LAWS ANN. ch. 156B § 65 (West 2004); MICH. COMP. LAWS § 450.1541A (2004); MINN. STAT. ANN. § 302A.251 (West 2003); MISS. CODE ANN. § 79-4-8.42 (2004); MONT. CODE ANN. § 35-2-441 (2003); N.H. REV. STAT. ANN. § 293-A:8.30 (2003); N.J. STAT. ANN. § 14A:6-14 (West 2004); N.M. STAT. ANN. § 53-4-18.1 (Michie 2004); N.Y. BUS. CORP. LAW § 717 (Consol. 2004); N.C. GEN. STAT. § 55-8-30 (2004); N.D. CENT. CODE § 10-19.1-50 (2003); OHIO REV. CODE ANN. § 1701.59 (Anderson 2004); OR. REV. STAT. § 60.357 (2003); PA. CONS. STAT. § 512 (2004); R.I. GEN. LAWS § 7-1.1-33 (2004); S.C. CODE ANN. § 33-8-300(2003); TENN. CODE ANN. § 48-18-301 (2003); VA. CODE ANN. § 13.1-690 (Michie 2004); WASH. REV. CODE ANN. § 23B.08.300 (West 2004); W.VA. CODE ANN. § 31D-8-830 (Michie 2003); WYO. STAT. ANN. § 17-16-830 (Michie 2003). The duty is defined by common law in a minority of jurisdictions. For example, in Arkansas directors are liable for failure to exercise diligence or good faith. *Sternberg v. Blaine*, 179 Ark. 448, 17 S.W.2d 286 (1929); *Johnson v. Coleman*, 179 Ark. 1087, 20 S.W.2d 186 (1929). (preceding decisions under prior law). See also *Christy v. Cambron*, 710 F.2d 669, 672 (10th Cir. 1983) (discussing the law in Colorado); *Holland v. American Founders Life Ins. Co.*, 376 P.2d 162 (Colo. 1962); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993); *Ferris Elevator Co. v. Neffco, Inc.*, 285 Ill. App. 3d (1996); *Sampson v. Hunt*, 665 P.2d 743, 754-5 (1983) (discussing the law in Kansas); *Speer v. Dighton Grain, Inc.*, 624 P.2d 952 (1981) (same); *Martin v. Webb*, 110 U.S. 7 (Mo. App. 1884); *Kirrane v. Boone*, S.W.2d 861 (1933) (discussing the law in Missouri); *Sletteland v. Roberts*, 16 P.3d 1062 (2000) (law of Montana); *Electronic Dev. Co. v. Robson*, 28 N.W.2d 130 (1947) (law of Nebraska); *Buchanan et al. v. Henderson* 131 B.R. 859 (D. Nev. 1990), *rev'd on other grounds*, *Henderson v. Buchanan et al.*, 985 F.2d 1021 (9th Cir. 1993) (discussing the law of Nevada); *Crews v. Garber*, 111 P.2d 1080, 1082 (1941) (pertaining to bank directors in Oklahoma); *Bowerman v. Hamner*, 250 U.S. 504 (1919) (discussing law of South Dakota).

²²⁵ Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565, 575 (2003) (discussing the insulation of managers from liability "in the absence of egregious conduct" and how the fiduciary duty of care in trust law "is not similarly buffered.").

²²⁶ See, e.g., Chittur, *supra* note 222, at 507-08 ("the business judgment rule has been part of the common law for nearly two centuries. . ."); Joseph Hinsey, *Business Judgment and The American Law Institute's Corporate Governance Project: The Rule, the Doctrine and the Reality*, 52 Geo. Wash. L. Rev. 609 (1984) ("the business judgment rule . . . has been part of the common law for at least 150 years . . .").

²²⁷ 2 Atk. 400, 26 Eng. Rep. 642 (Ch. 1742).

²²⁸ See *Percy v. Millaudon*, 8 Mart. (n.s.) 68, 78 (La. 1829).

²²⁹ See *Hodges v. New England Screw Co.*, 1 R.I. 312 (1850), *reh'g granted*, 3 R.I. 9 (1853).

²³⁰ *Id.* at 346.

²³¹ 25 N.Y.S.2d 667 (N.Y. Sup. Ct. 1940).

²³² *Id.* at 677-78.

²³³ *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

²³⁴ *Aronson*, 473 A.2d at 812. See also Rock & Wachter, *supra* note 199, at 659.

²³⁵ AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §4.01 (1994). See also, Douglas M. Branson, *The Rule that Isn't a Rule – The Business Judgment Rule*, 36 VAL. U. L. Rev. 631, 634-35 (2002).

²³⁶ Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 845, 964 (1990); Ralph A. Peeples, *The Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 NOTRE DAME L. REV. 456, 461 (1985); Marcia M. McMurray, *Special Project: Director and Officer Liability, An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 605 617 (1987). See also *Resolution Trust Corp. v. Blasdell*, 820 F. Supp. 417, 423 (D. Ariz. 1994); *Washington Bancorporation v. Said*, 812 F. Supp. 1256, 1267-68 (D.D.C. 1993).

²³⁷ McMurray, *supra* note 236, at 610; E. Norman Veasey, et al., *Responses to the D&O Insurance Crisis*, 19 SEC. & COMMODITIES REG. 263, 265 (1986) (regarding response to the liability imposed by the Delaware Supreme Court in *Smith v. Van Gorkom*). Commentators have also noted the difficulty in providing an objective standard from which to judge corporate behavior. *See, e.g.*, Conference Panel Discussion, *The Business Judgment Rule*, 45 OHIO ST. L.J. 629, 648-49 (comments of Dean Manning); Hal R. Arkes & Cindy A. Schipani, *Medical Malpractice v. the Business Judgment Rule: Differences in Hindsight Bias*, 73 OREGON L. REV. 587, 624 (1994) (there is "no commonly accepted methodology as to what a business person should do when faced with every business situation").

²³⁸ Helfman v. American Light & Traction Co., 187 A. 540, 550 (N.J. Ch. 1936); Liebman v. Auto Strop Co., 241 N.Y. 427, 433-4 (1926). *See also* Sinclair Oil Corp. v. Levien 280 A.2d 717 (Del. 1971) (stating the board of directors enjoy a presumption of sound business judgment and when based on any rational business purpose a court will not disturb).

²³⁸ *See, e.g.*, Horsey, *supra* note 199, at 978. *See also* Chittur, *supra* note 222, at 508.

²³⁹ John Gibeaut, *Stock Responses*, ABA JOURNAL 38, 41 (Sept. 2003).

²⁴⁰ Joseph Hinsey, *Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609, 609 (1984). *See also* Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 465 (2004). In *Davis v. Louisville Gas & Electric*, one of the early courts discussing the business judgment rule, the court found a rebuttable presumption in favor of the directors of the corporation where the decision was made in good faith and for the best interests of the corporation. 142 A. 654, 659 (Del. Ch. 1928).

²⁴¹ *See, e.g.*, Horsey, *supra* note 199, at 978. *See also* Chittur, *supra* note 222, at 508. Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 17-19 (1989).

²⁴² *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

²⁴³ *See* Gibeaut, *supra* note 239, at 41 (comment of Chief Justice Veasey).

²⁴⁴ *See* Hinsey, *supra* note 240, at 610.

²⁴⁵ *See id.*

²⁴⁶ *See* Horsey, *supra* note 199, at 980.

²⁴⁷ *See id.*

²⁴⁸ Shlensky v. Wrigley, 237 N.E.2d. 776 (Ill. App. 1968).

²⁴⁹ *Id.* at 778.

²⁵⁰ *Id.* at 777.

²⁵¹ *Id.* at 778.

²⁵² *Id.* at 780.

²⁵³ *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

²⁵⁴ MARINA WHITMAN, NEW WORLD, NEW RULES 83 (1999).

²⁵⁵ *See* Rock & Wachter, *supra* note 199, at 651.

²⁵⁶ *Van Gorkom*, 488 A.2d at 858

²⁵⁷ *Id.* at 864.

²⁵⁸ *Id.* at 865.

²⁵⁹ *Id.*

²⁶⁰ *Id.* at 866.

²⁶¹ *Id.* at 866-67.

²⁶² *Id.* at 868-69.

²⁶³ *Id.* at 870.

²⁶⁴ *Id.* at 864.

²⁶⁵ *Id.* at 899.

²⁶⁶ *Id.* at 888.

²⁶⁷ *Id.* at 874.

²⁶⁸ *Id.* at 874, 877.

²⁶⁹ *Id.* at 876.

²⁷⁰ *Id.* at 884.

²⁷¹ *Id.* at 874

²⁷² *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993).

²⁷³ *Id.* at 371.

²⁷⁴ *Id.* (Cinerama met the burden to rebut the presumption of the business judgment rule).

²⁷⁵ *In re General Motors Class H Shareholders Litigation*, 734 A.2d 611 (Del. Ch. 1999).

²⁷⁶ *Id.*

²⁷⁷ *Id.* at 612.

²⁷⁸ *Id.* at 616.

²⁷⁹ *Id.*

²⁸⁰ 432 A.2d 814 (N.J. 1981).
²⁸¹ *Id.* at 819
²⁸² *Id.*
²⁸³ *Id.* at 818
²⁸⁴ *Id.*
²⁸⁵ *Id.* at 825-26.
²⁸⁶ *Id.* at 826.
²⁸⁷ 188 A.2d 125 (Del. 1963).
²⁸⁸ *Id.* at 130.
²⁸⁹ *Id.* at 129.
²⁹⁰ *Id.*
²⁹¹ *Id.*
²⁹² *Id.*
²⁹³ *Id.* at 131
²⁹⁴ *Id.* at 130.
²⁹⁵ *Id.* at 130.
²⁹⁶ 698 A.2d 959 (Del. Ch. 1996).
²⁹⁷ *Id.* at 962.
²⁹⁸ *Id.* at 969-70.
²⁹⁹ *Id.* at 970. “Neither party presented evidence on the relevant issue under *Caremark*: the extent of the board's oversight of the Marvel employees. Alleging that the board should have known of the employees' actions without further proof is not enough to support plaintiffs' summary judgment motion. Similarly, showing that no company policy encouraged misrepresentations is not dispositive of whether the board fulfilled its monitoring responsibilities under *Caremark*. Thus, such arguments do not support defendants' motion for summary judgment. Since neither party presented the necessary evidence, the court will cannot grant summary judgment for either party on this issue at this time.” *Cantor v. Perelman*, 235 F. Supp. 2d 377, 389 (D. Del. 2002).
³⁰⁰ *Guttman v. Huang*, 823 A.2d 492 (Del. Ch. 2003).
³⁰¹ *Id.* at 496.
³⁰² *Id.* at 498.
³⁰³ *Id.* at 506.
³⁰⁴ *Id.*
³⁰⁵ 833 A.2d 961, 970-1 (Del. Ch. 2003).
³⁰⁶ *Id.*
³⁰⁷ 188 A.2d 125 (Del. 1963).
³⁰⁸ *Id.* at 125, 130.
³⁰⁹ 833 A.2d at 972.
³¹⁰ *See, e.g., Sale, supra* note 240 (arguing that Delaware case law “reveal[s] an emerging doctrine of good faith”). The cases include: *Emerald Partners v. Berlin*, 787 A.2d 85, 80 (Del. 2001); *McMullin v. Beran*, 765 A.2d 910, 918 (Del. 2000); *Scattered Corporation v. Chicago Stock Exchange*, 701 A.2d 70 (Del. 1997).
³¹¹ E. Norman Veasey, *State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors*, 28 J. CORP. L. 441, 447 (2003).
³¹² 8 DEL. CODE § 102(b)(7) (2004).
³¹³ Veasey, *supra* note 311, at 447.
³¹⁴ *In re Walt Disney Co. Derivative Litigation*, 825 A.2d 275 (Del. Ch. 2003).
³¹⁵ *Brehm v. Eisner*, 746 A.2d 244 (Del. Sup. Ct. 2000).
³¹⁶ *Walt Disney Co.*, 825 A.2d. at 289.
³¹⁷ *Id.* at 287
³¹⁸ *Id.* at 287-88
³¹⁹ *Id.*
³²⁰ Section 102(b)(7) of the Delaware Code provides that the articles of incorporation may include:
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 section 174 of this Title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to

the date when such provision becomes effective. All references in this subsection to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.

8 Del. Code § 102(b)(7) (2004).

³²¹ 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, 382 (1988) (“because severe forms of negligence rising to the level of conscious disregard are akin to intentional conduct, in all probability these shareholders will continue to be able to obtain damage recoveries for the corporate treasury whenever directors have been reckless”).

³²² *Aronson v. Lewis*, 473 A.2d 805, 812 (Del., 1984); *Ferris Elevator Co. v. Neff Co., Inc.*, 285 Ill. App. 3d 350, 354 (1996); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994). See also Brudney, *supra* note 195, at 601.

³²³ RESTATEMENT (SECOND) OF TRUSTS § 170(1) Comment A (1992).

170 Duty of Loyalty [as Revised]

(1) The trustee is under a duty to administer the trust solely in the interest of the beneficiaries.

RESTATEMENT (SECOND) OF TRUSTS § 170.

³²⁴ *Id.* at § 170(2).

³²⁵ 164 N.E. 545 (Ct. App. N.Y. 1928).

³²⁶ *Id.* at 546.

³²⁷ *Id.*

³²⁸ See Walsh, *supra* note 199, at 334.

³²⁹ JOEL SELIGMAN, *CORPORATIONS CASES AND MATERIALS* 415 (1995).

³³⁰ *Guth v. Loft*, 5 A.2d 503 (Del. 1939).

³³¹ *Id.* at 510.

³³² *Id.*

³³³ See Clobes, *supra* note 125, at 226-27 (“The recent trend favors imposing upon fiduciaries the common law rule requiring them to disclose material information concerning existing plans and benefits when they know that silence might be harmful.”); Czerniawski, *supra* note 125, at 808 (“There has been considerable disagreement among the lower courts dealing with disclosure of proposed benefit changes, but there has been a trend towards a ‘serious consideration’ test as triggering fiduciary disclosure duties in these cases.”); Stover, *supra* note 125, at 691 (stating “the current trend in the federal courts [is] to expand a plan administrator’s disclosure duties by emphasizing her fiduciary obligation to provide material information to plan participants.”).

³³⁴ See Clobes, *supra* note 125, at 226-27; Czerniawski, *supra* note 125, at 808; Stover, *supra* note 125, at 691.

³³⁵ Clobes, *supra* note 125, at 227.

³³⁶ *Kuper v. Lovenko*, 66 F.3d 1447 (6th Cir. 1995); *Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995).

³³⁷ *In re Enron Corp. Securities, Derivative & “ERISA” Litig.*, 284 F. Supp. 2d 511, 658-59 (S.D. Tex. 2003).

³³⁸ LOSS & SELIGMAN, *supra* note 20, at § 9-B-4.

³³⁹ See LOSS & SELIGMAN, *supra* note 20, at § 2-B-1.

³⁴⁰ See *supra* text accompanying notes 33-44.

³⁴¹ *In re Enron Corp. Securities, Derivative & “ERISA” Litig.*, 284 F. Supp. 2d 511, 563-67 (S.D. Tex. 2003).

³⁴² See *supra* text accompanying note 32.

³⁴³ See *supra* text accompanying notes 30-31.

³⁴⁴ See *supra* text accompanying note 114.

³⁴⁵ See *supra* text accompanying notes 188-92.

³⁴⁶ ERISA §§ 502(a)(1)(B), 29 U.S.C. §§ 1132(a)(1)(B) (2000).

³⁴⁷ *Supra* text accompanying notes 190-92.

³⁴⁸ LOSS & SELIGMAN, *supra* note 20, at § 11-C-4.

³⁴⁹ As a side note, corporate officials that subject the corporation to liability for ERISA violations could incur personal liability exposure for breach of their corporate law fiduciary duty of care. If the basis of a shareholder claim involved a business decision, the case would turn on whether the defendants obtained all reasonably information before making the decision; whether the decision was made in good faith; and whether the defendants fulfilled their duty of loyalty. If the answer to any of these questions is no, there may be liability for breach of fiduciary duty.

³⁵⁰ *Supra* text accompanying notes 142-43.

³⁵¹ *Supra* text accompanying notes 236.

³⁵² *Supra* text accompanying note 144.

³⁵³ *Unocal v. Mesa Petroleum Corp.*, 493 A.2d 946 (Del. 1985).

³⁵⁴ *Revlon Inc. v. MacAndrew & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

³⁵⁵ *Supra* text accompanying notes 157-65.

³⁵⁶ In re Enron Corp. Securities, Derivative & “ERISA” Litig., 28 F. Supp. 2d 511, 661 (S.D. Tex. 2003).

³⁵⁷ *Id.* at 554 (*quoting* Newton v. Van Otterloo, 756 F. Supp. 1121, 1132 (N.D. Ind. 1991).

³⁵⁸ http://www.quotationspage.com/quotes/Warren_Buffett (last visited June 1, 2004).