DIRECTORS' DUTIES OF LOYALTY: IS IT STILL A MATTER OF HONOR?

by

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I. Introduction

Seventy-seven years have passed since Chief Justice Cardozo opined that joint adventurers owe one another "the duty of the finest loyalty."[1] He described this standard with the famous phrase: "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."[2] One might logically expect the elapsed years and wealth of state corporate law litigation to have defined any remaining contours in corporate directors' duties of loyalty. Such logic, however, is not justified in this instance. In a recent opinion, which has become well known for other reasons,[3] the Delaware Chancery Court stated: "[T]he Delaware Supreme Court has yet to articulate the precise differentiation between the duties of loyalty and of good faith."[4]

At the same time that Delaware law on directors' fiduciary obligation of loyalty has come under scrutiny, directors are increasingly facing fiduciary litigation under the Employee Retirement Income Security Act of 1974 (ERISA).[5] In one significant category of recent cases, the "ERISA stock drop" cases, plaintiffs typically allege directors breached their fiduciary duty of loyalty vis-à-vis the employees' investment in company stock where the investment was made through employer-sponsored benefit plans. The scope of directors' fiduciary obligations in those cases has become the subject of considerable litigation.

In this article we consider the developing standards of loyalty governing director conduct and the tension between state and federal standards. Part II describes the development of the fiduciary duty of loyalty in trust law. Part III evaluates the duty of loyalty imposed on directors by Delaware corporate law with special emphasis on the Chancery court opinion in *In re: Emerging Communications, Inc. Shareholders Litigation.*[6] Part IV analyzes the fiduciary loyalty obligations imposed by ERISA. It then examines the application of loyalty principles in the specific context of the ERISA stock drop cases. Part V scrutinizes the significant ways in which the duty of loyalty jurisprudence in Delaware corporate law and the federal law of ERISA is diverging. We show that some of the divergence is attributable to meaningful differences between the two areas. We conclude, however, that both Delaware corporate law and the federal law of ERISA must continue to give serious and flexible content to the fiduciary duty of loyalty.

II. Trust Law as the Source of the Fiduciary Duty of Loyalty

State corporate law and federal employee benefit plan law both have relied on trust law to shape the development of fiduciary obligations for those areas of law. Looking specifically at the obligation of loyalty, trust law provides that a trustee must act "solely in the interest of the [trust] beneficiaries."[7] In situations where there are multiple current beneficiaries, the trustee must be impartial among those beneficiaries.[8] Similar obligations arise when the trust provides for successive and multiple successive beneficiaries.[9]

Historically trustees have been subject to harsh conflict of interest standards. When a fiduciary acts in a transaction where her personal interest conflicts with the trust's interest the basic rule is to conclusively presume the transaction to be invalid.[10] This approach is intended to negate the agency assumption that a trustee acting under the temptations inherent in a conflict of interest will all too often neglect the best interests of the beneficiary.[11]

Given both the draconian nature of trust law's conclusive presumption and the changing nature of trusts and trustees, over time exceptions have developed to permit specific categories of interested transactions.[12] This approach has recently been questioned, with one commentator suggesting that the presumption of invalidity should be rebuttable, permitting the trustee to defend a breach of loyalty claim by proving the transaction was in the beneficiary's best interest.[13]

III. Corporate Law Fiduciary Standards

The concept of fiduciary duty, as applied to corporate officers and directors, is a significant part of the corporate

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law jurisprudence.[14] The most salient duties are the duties of care and loyalty,[15] juxtaposed with the obligation to act in good faith.[16] As will be discussed below, this juxtaposition, however, is currently open to interpretation.

Although the duty of care imposes upon directors an affirmative duty to use reasonable care under the circumstances in making corporate decisions, there are relatively few cases pursuant to which directors have been held personally liable for breach of due care.[17] Prior to 1987, the most likely reason for the paucity of cases is the rule employed by the courts known as the business judgment rule. Where the presumptions of the business judgment rule apply, courts have been loathe to second guess business decisions. In order to qualify for business judgment rule protections, the directors must have acted in good faith, and in the best interest of the corporation.[18] The business judgment rule only applies to protect affirmative decision-making where there is no evidence of bad faith or breach of the duty of loyalty.

In 1986, Delaware adopted Section 102(b)(7) of the Delaware Code to provide that corporations may limit, or eliminate the potential liability of corporate directors for breach of the duty of care by including an exculpatory provision in the company's articles of incorporation.[19] Nearly all states have followed suit and have adopted similar legislation.[20] Thus, post-1986, not only are directors protected from liability through the business judgment rule jurisprudence, they are also protected by the 102(b)(7)-type exculpation provided in the articles of incorporation of the firms they serve.

Between the protections afforded by the business judgment rule and the exculpatory legislation adopted by most states, the duty of care analysis appears to turn on the exceptions to the rule. Neither business judgment rule protection nor exculpation is available for acts in violation of the duty of loyalty or lacking in good faith. Thus, now that liability does not attach for negligent or grossly negligent violations of due care, claims regarding breach of loyalty or lack of good faith take on added significance. These issues were at the forefront of plaintiffs' claims in *In re Emerging Communications, Inc. Shareholders Litigation.*[21]

A. *In re Emerging Communications, Inc. Shareholders Litigation*

In *In re Emerging Communications, Inc. Shareholders Litigation* (*ECM),*[22] the Delaware Chancery Court recently considered allegations of breach of the duties of care, loyalty and good faith in connection with a decision made by the board of directors. The *ECM* plaintiffs were former minority shareholders of Emerging Communications, Inc. (ECM) who sold their stock to Innovative Communications Corporation (Innovative) in a two-step transaction designed to take the company private.[23] Innovative was owned by Innovative Communication Company (ICC), which was also a majority shareholder of ECM. ICC in turn was owned by ECM's Chairman and Chief Executive Officer, Jeffrey Prosser. Prosser thus had voting control over both ECM and Innovative. The plaintiffs filed two separate actions, the first requesting a statutory appraisal of the value of the shares sold, and the second, a class action claiming that the transaction was not entirely fair to the ECM minority shareholders and thus was in breach of the directors' fiduciary duties.[24] The claims were consolidated by the court.[25]

In considering the claim of breach of fiduciary duty, the court cited the Delaware Supreme Court decision in *Emerald Partners v. Berlin*[26] and determined that analyzing a "going private" transaction and the liability of the fiduciaries, utilizes the entire fairness test.[27] This test required a determination of both fair dealing and fair price.[28]

The court first made a determination of the fairness of the price paid for the shares.[29] After a lengthy financial analysis, the court rejected the defendants' claim that the price was fair. The court held that the $10.25 price paid to the minority shareholders for the shares represented neither the fair value nor the intrinsic value at the time of the merger.[30] Instead, the court determined that the fair value at the time of the transaction was $38.05 per share.[31]

Once the court determined that the price was unfair, the question became whether a fair dealing analysis was necessary.[32] The Chancery Court noted that Delaware law had not yet determined whether an unfair price establishes "*ipso facto*, the unfairness of the merger, thereby obviating the need for any analysis of the process oriented issues."[33] The court found, however, that a fair dealing analysis was required because a Section 102(b)(7) exculpatory defense had been raised by defendants,[34] "if only to enable the Court to determine the 'basis for the [defendants'] liability' for *§ 102(b)(7)* exculpation purposes."[35] The determination of an unfair price did not "address whether the unfairness was the product of a breach of fiduciary duty or if so, the nature or character of that duty."[36]

The court then proceeded with a fair dealing analysis. The court reviewed "when the transaction was timed, how it was initiated, structured, negotiated, and disclosed to the board, and how director and shareholder approval was obtained."[37] An analysis of these factors led the court to conclude that the privatization transaction was not entirely fair.[38] Prosser's original intent, in about January, 1998, was not to privatize the company but instead to merge Innovative into a subsidiary of ECM.[39] But by May, 1998, in light of the low market interest in ECM's common stock, Prosser decided to "flip the transaction,"[40] and become a buyer instead of a seller. Based on these facts the court found that this transaction, which was initiated by a majority stockholder to freeze out the minority shareholders at a time when the stock price was artificially low, was unfair in both its initiation and timing.[41]

When Prosser was contemplating the original merger transaction, he engaged the Prudential firm to evaluate the fairness of the merger for ECM and the Cahill, Gordon and Reindel (Cahill) law firm to assist ECM with drafting the terms of the merger.[42] When Prosser later decided to privatize, he hired both Prudential and Cahill to advise him personally with regard to the privatization transaction.[43] By co-opting Prudential and Cahill, Prosser thus deprived ECM's board of valuable advisors.[44] The court found these facts indicative of unfairness in the structure of the transaction.[45]

The next question addressed by the court was whether a transaction adjudicated to be not entirely fair violates the duty of care, the duty of loyalty, or the duty of good faith? If the violation is solely one of due care, ECM's 102(b)(7)-type provision would exonerate the directors from money damages. But this exoneration is not applicable "(i) for any breach of the director's duty of loyalty, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law. . . ."[46]

The *ECM* court went on to determine the nature of the fiduciary duties for each director individually. Prosser, the Chairman, CEO and controlling stockholder, was found to have breached his duty of loyalty "by eliminating the minority shareholders of ECM at an unfair price in an unfair transaction."[47] Furthermore, Prosser received an improper personal benefit from the transaction, which also nullifies the exculpation provision.

Director Raynor was also found to have breached his duty. Raynor did not personally profit from the transaction as Prosser did, but he furthered Prosser's interests which were opposed to the interests of the minority shareholders. Raynor was a practicing attorney and had served both as Prosser's personal attorney and ECM's counsel.[48] He acted as an advisor to Prosser in connection with the privatization transaction.[49] The court further noted that Raynor's economic interests were tied to Prosser. The court seemed to find it significant that Raynor was not, therefore, independent of Prosser but the court is not clear whether the lack of independence implicates the duty of loyalty. Interestingly, the court did not determine whether Raynor violated the duty of loyalty or of good faith. Instead the court held that he has breached "his fiduciary duty of loyalty and/or good faith."[50] The court explains this unusual finding by noting that the Delaware Supreme Court "has yet to articulate the precise differentiation between the duties of loyalty and good faith."[51] It further stated that "[I]f a loyalty breach requires that the fiduciary have a self-dealing conflict of interest in the transaction itself . . . then . . . Raynor would be liable [only] for violating his duty of good faith for consciously disregarding his duty to the minority stockholders. . . . On the other hand, if a loyalty breach, does not require a self-dealing conflict of interest or receipt of an improper benefit, then Raynor would be liable for breaching his duties of loyalty and good faith."[52] The court did not decide the issue, because regardless of the finding, Raynor's conduct would not be exculpated.[53] Yet, the court found that good faith was violated either way. From this finding, it is then logical to infer that good faith is a fiduciary duty separate from the duties of loyalty or care and that conscious disregard for duties violates the duty of good faith.

The court then addressed the liability of director Muoio. Muoio was also held liable for breach of the duty of loyalty and/or good faith,[54] although the court found his conduct less egregious than that of his co-defendants, Prosser and Raynor.[55] Muoio was held liable "because he voted to approve the transaction even though he knew, or at the very least had strong reasons to believe, that the $10.25 per share merger price was unfair."[56] The court based this finding on the fact that Muoio had significant experience in finance and telecommunications in light of his position with an investment advising firm.[57] The court held that Muoio should have advised the board to reject the $10.25 price and formally voted against the transaction at this price.[58] Here again, rather than delineate between the duties of loyalty and good faith, the court held that Muoio's conduct violated the duty of "loyalty and/or good faith."[59] Taken in light of the court's finding with regard to Raynor, it thus appears that the "conscious disregard" standard that the court is applying in the context of good faith is breached if the director "knew or had strong reasons to believe" that a transaction was unfair.

It is also interesting that Muoio was found not to be independent of Prosser. The court noted that Muoio's independence was in question because he would likely wish to seek future business opportunities from Prosser. However, it appears that the court was uncertain regarding whether this lack of independence was enough of a conflict of interest to raise concerns about the duty of loyalty. The court did not find a conflict of interest between Muoio and the transaction, rather the conflict concerned Muoio's lack of independence from Prosser. Instead of making the determination regarding whether a conflict in the transaction is a necessary finding in a loyalty case, the court sidestepped the issue and found Muoio in violation of loyalty and/or good faith.

The four remaining directors, Goodwin, Ramphal, Todman, and Vondras were not found liable for breaching either the duty of loyalty or good faith. With respect to these directors, the court found that the evidence did not implicate more than breach of the duty of care. None of these directors had received an improper personal benefit, nor did any of them have a personal conflicting financial interest in the transaction. There was no evidence that "they deliberately engaged in conduct disloyal to the minority stockholders' interests." [60] Nor did the court find that they "knew or had reason to believe, that the merger price [was] unfair."[61]

It is perplexing that the *ECM* court did not decide whether the duty of loyalty or the obligation of good faith was breached in the cases of Muoio and Raynor, but in effect stated that good faith was breached and loyalty may have been. Yet, a determination of the precise contours of the duty of loyalty and good faith could become important in deciding future cases. This is especially significant as the Delaware courts are in the midst of deciding high-profile cases involving good faith.[62] Judge Easterbrook and Professor Fischel once commented that the law related to veil-piercing is among the most confusing area of corporate law.[63] Today, especially in the aftermath of *ECM*, the contours of the duty of loyalty and the obligation of good faith may be in contention for that dubious honor. The next section revisits the duty of loyalty and the obligation of good faith, with an objective of picking up the analysis where the *ECM* court left off.

B. The Duty of Loyalty

As discussed above, the fiduciary duties in corporate law, including the duty of loyalty, have their genesis in the law of trusts.[64] A fiduciary relationship exists, "when one is given power that carries a duty to use that power to benefit another."[65] This relationship is placed upon trustees and their beneficiaries and upon agents and their principals.[66] Although corporate officers and directors as fiduciaries are not formally considered trustees of the organizations they serve,[67] corporate law analogizes to the fiduciary obligations of trustees when determining the scope of corporate fiduciary duties,[68] albeit without much discussion.

It has become well-established in corporate law that a conflict of interest will trigger a duty of loyalty analysis.[69] What is murky, in light of the decision in *ECM*, is whether lack of independence is enough of a conflict to implicate the duty of loyalty, or whether a more direct conflict of interest in the transaction itself is required. These issues are discussed below.

1. Conflict of Interest in the Transaction

The case law is relatively clear that a conflict of interest by a director in a corporate transaction will trigger an analysis of whether there is a breach of the duty of loyalty.[70] The duty of loyalty requires corporate officers and directors to refrain from using their corporate position of trust and confidence for their own benefit.[71] 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."[72] In *Guth v. Loft*,[73] the Delaware Supreme Court analogized to the law of trusts in finding 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.[74] The court said that a director is obligated to "affirmatively . . . protect the interests of the corporation committed to his charge."[75]

Although the duty of loyalty requires the "punctilio of an honor the most sensitive," conflicts of interest do not automatically give rise to breach. It should be noted, however, that where a transaction gives rise to a conflict of interest between members of the board and the corporation, the presumptions of the business judgment rule or of 102(b)(7)-type exculpatory provisions no longer apply to protect the business decisions of the board members. If the conflict in a transaction is disclosed and disinterested members of the board approve the transaction, there will generally be no cause for liability.[76] If a transaction is contested because the decision was not made by a disinterested board, a court will likely evaluate the transaction substantively for fairness.[77] For example, the fairness standard was applied by the court in *Cinerama, Inc. v. Technicolor, Inc*.,[78] where the plaintiff alleged that the defendant directors violated their duty of loyalty in approving a merger. The court held that the burden of proof shifted to the directors to prove the entire fairness of the transaction because the business judgment rule was rebutted. The court stated that in assessing the entire fairness of a transaction, "the court must consider the process itself that the board followed, the quality of the result it achieved and the quality of the disclosures made to the shareholders to allow them to exercise such choice as the circumstances could provide."[79] The court affirmed the decision of the lower court, holding that its use of a disciplined balancing test in determining fairness and credibility would not be disturbed.[80]

2. Lack of Independence

A question left unanswered by the *ECM* court is whether lack of independence is enough of a conflict of interest to implicate the duty of loyalty. In finding Raynor and Muoio liable for breach of loyalty and/or care, the court stated that loyalty was only implicated if a conflict of interest in the transaction itself was not required. Raynor and Muoio were not found to be interested in the transaction. They were, however, connected to Prosser and not independent advisors to the company.

Although lack of independence is not an issue that has been decided by the Delaware Supreme Court in the context of a claim for breach of loyalty, it is an issue that has been addressed recently by the Chancery Court. For example, in *Orman v. Cullman*,[81] the Delaware Chancery Court stated that to establish a breach of the directors' duty of loyalty and to overcome the presumption of the business judgment rule, the plaintiff must "establish that the *board* was either interested in the outcome of the transaction or lacked the independence to consider objectively whether the transaction was in the best interest of its company and all of its shareholders. To establish that a *board* was interested or lacked independence, a plaintiff must allege facts as to the interest and lack of independence of the *individual members* of that board."[82] The court further delineated the distinction between interest in the transaction and lack of independence. According to *Orman*, directors are interested in the transaction when they appear on both sides of a transaction or expect to derive a personal financial benefit from it in the sense of self-dealing. This is in contrast to "a benefit which devolves upon the corporation or all stockholders generally."[83] On the other hand, "lack of independence can be shown when a plaintiff pleads facts that establish ‘that the directors are ‘beholden’ to [a controlling person] or so under their influence that their discretion would be sterilized.’”[84]

The *Orman* court then discussed whether the plaintiffs’ allegations of breach of fiduciary duty were sufficient to survive the motion to dismiss. Four defendant directors were alleged to be interested in the transaction “because they received benefits from the transaction that were not shared with the rest of the shareholders.”[85] The court found the allegations insufficient with respect to three of the directors, Israel, Vincent and Lufkin. The only allegation against Israel and Vincent was that they had served on the board since 1989 and 1992, respectively.[86] With respect to Lufkin, his board membership since 1976 was insufficient to show lack of independence and his role as founder of one of the two leading underwriters of the company’s IPO did not establish that he received a personal benefit from the transaction not shared by other shareholders.[87] Similarly, Director Barnet was not interested in the transaction solely because he was to be a director in the surviving corporation.[88]

On the other hand, the court found that Director Bernbach may have lacked independence because he was beholden to the Cullman Group – the group that negotiated the transaction – due to his consulting contract with that company and was beholden to the controlling shareholders for a continuation of the contract.[89] Interestingly, the court stated that the consulting contract was not enough to establish that Bernbach was interested or that he would have profited from the transaction.[90] Bernbach’s potential liability was on independence alone.

Director Solomon was possibly interested in the transaction where his company, PJSC, was to receive a $3.3 million fee if the merger was approved.[91] Finally, the court found it unnecessary to rule upon the interest or lack of independence of director Sherren because a majority of the board being interested or lacking independence was sufficient to rebut defendants’ claim that the decision was protected by the business judgment rule.[92]

Similarly, the U.S. district court, applying Delaware law, in *Hollinger International, Inc. v. Hollinger Inc.*,[93] utilized a two-prong test in its discussion of the duty of loyalty. According to *Hollinger*, a breach of loyalty claim requires plaintiff to allege that: “(1) the director was ‘interested in the outcome’ of the alleged self dealing transaction; or (2) ‘lacked independence to consider objectively whether the transaction was in the best interest of the company and all its shareholders.’”[94] In this case, plaintiff alleged that defendants Black and Radler engaged in various self-dealing transactions, including receiving non-competition payments from Hollinger International, Inc. (International), selling International’s assets at below-market prices to a corporation controlled by Black and Radler, loaning International’s funds to a corporation controlled by Black and Radler at below-market interest rates, and receiving ‘‘‘unwarranted, excessive, and unauthorized’ ‘management fees,’ ‘incentive payments,’ and other compensation.”[95] Defendant Perle was a director of International and sat on its audit, compensation, and executive committees.[96] At the same time, Perle was an officer of Digital Management, a company which, according to plaintiffs, received excessive fees for managing International’s investments.[97]

The court found that plaintiff had not alleged that defendant Perle had a direct financial interest in the transactions at issue, but had sufficiently pleaded lack of independence. “To sufficiently plead ‘lack of independence,’ the plaintiff must allege ‘particularized facts’ supporting ‘a reasonable inference’ that the director was ‘beholden’ to the controlling shareholder through a close personal, family, or business relationship. A director is ‘considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over decision makers), to decide whether the director continues to receive a benefit, financial or otherwise,’ which is of material importance to the director.”[98] According to the court, because Black had Perle appointed CEO of Digital Management, a subsidiary of International, where he received over $3.1 million in incentive payments, plaintiff sufficiently alleged that Perle lacked independence from Black.[99]

As lack of independence becomes significant to considerations of loyalty claims it may be instructive to also consider the developing case law on independence in other areas of corporate law. For example, independence has become a significant concern of the courts in shareholder derivative litigation.[100]

Boards may appoint special litigation committees (SLCs) to make decisions regarding whether derivative litigation should be pursued or terminated. In *Zapata Corp. v. Maldondo*,[101] the Delaware Supreme Court articulated a two-step analysis for evaluating the decision of a special litigation committee. This analysis requires the court to evaluate the independence and good faith of the members of the special litigation committee and permits the court to use its own business judgment to determine whether it is in the best interest of the corporation for the suit to be either continued or terminated.[102]

The lynchpin of the willingness of courts to defer to the special litigation committee is the independence of that committee. Recently, in In re *Oracle Corp. Derivative Litigation*, the Delaware Chancery Court considered whether the special litigation committee members, both of whom were Stanford University faculty members and Oracle Corp. (Oracle) directors, were independent from the director defendants who also bore significant ties to Stanford.[103] The court noted that independence "turns on whether a director is, *for any substantial reason*, incapable of making a decision with only the best interests of the corporation in mind."[104] In *Oracle*, the court noted the various ties defendant directors had with Stanford.[105] One defendant was a Stanford professor, had served with an SLC member at the Stanford Institute for Economic Policy Research (SIEPR), and had also taught one of the SLC members when the SLC member was a Ph.D. student at Stanford.[106]

Another defendant was a Stanford alumnus who served as chair on the SIEPR board and who directed multi-million dollars in contributions to Stanford recently.[107] A third defendant donated millions of dollars to Stanford in both personal donations and indirectly through the corporation, and was considering further donations of hundreds of millions of dollars, around the time that the SLC members had been appointed to the corporate board.[108] These facts gave the court reasonable doubt concerning the independence of the SLC members.[109] The court further noted that the burden of proof rests with the SLC to establish its independence[110] and denied the SLC's motion to terminate the derivative litigation.[111] The ties among the SLC members and the defendants were, according to the court, so substantial that that they cast doubt about the impartiality of the SLC.[112]

Independence was also at issue recently in *In re eBay Shareholders Litigation*.[113] Like the Oracle shareholders, the eBay shareholders were permitted to proceed with their claim against the directors and officers of eBay. Demand was said to be futile and the litigation permitted to proceed over the objection of the non-defendant directors. The court was not convinced that the non-defendant directors could "objectively and impartially consider a demand to bring litigation against those to whom [they are] beholden for [their] current position on eBay's board."[114] The court reached this conclusion after noting that the defendant directors owned enough stock to control the corporation and the election of directors. Along with this concern, was the concern that the non-defendant directors owned options that had not vested, and would not vest unless they continued to serve as directors of eBay. Some of these options were worth millions of dollars. These facts led the court to conclude that demand would be futile because the non-defendant directors were not sufficiently impartial.[115]

These cases show that various interests in the outcome, or relationships with the parties involved, may show the lack of independence of special litigation committees. These cases may become important in the duty of loyalty context, as guidelines for determining independence.

3. Origins of Loyalty

It may also be instructive to consider the origins of the duty of loyalty to analyze whether evidence of a conflict of interest in the transaction is necessary to establish breach. As noted above, the corporate law fiduciary duties had their genesis in the law of trusts. 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 beneficiaries."[116] This definition does not seem to require self-dealing before finding a violation. However, if the transaction presents conflicts of interest, the trustee "is under a duty to deal fairly and to communicate to the beneficiary all material facts the trustee knows or should know in connection with the transaction."[117]

As mentioned above, 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*.[118] 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."[119] 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."[120] Thus, the duty of loyalty, at least in the earlier days of its interpretation, included a very strict duty of fair dealing and of high honor. Although evidence of conflict of interest in the transaction could lead to a finding of breach of the duty of loyalty, it did not seem to be a requirement of breach. That is, breach of loyalty could be evidenced by conflict of interest in the transaction or any other behavior indicating that the director did not communicate all material facts, or did not otherwise act with "the honor most sensitive."

The logical import from this reasoning is that the *Orman* and *Hollinger* courts are correct in their determination that a conflict of interest in the transaction, although a sufficient condition to trigger a loyalty analysis, is not the only condition that would trigger such analysis. It would seem that other conflicts of interest, such as the lack of independence, would also violate the obligation to act with "the honor most sensitive."

C. Where Does Good Faith Fit In?

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.[121] An earlier complaint was dismissed in *Brehm v. Eisner*,[122] because the complaint did not allege sufficient facts to overcome the presumption of the business judgment rule. The later complaint alleged that the "board of directors consciously and intentionally disregarded their responsibilities."[123] The court let the claim stand for a determination whether the board "exercised any business judgment or made any good faith attempt to fulfill the duties they owed to Disney and its shareholders."[124] 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.[125] There were also issues raised concerning the later no-fault termination of the contract on terms favorable to Ovitz. There is no record of the full board or of the compensation committee reviewing these terms.[126] Therefore, the Delaware Chancery Court in

Disney let stand a complaint that alleged that the directors "failed to exercise *any* business judgment and failed to make *any* good faith attempt to fulfill their fiduciary duties to Disney and its stockholders."[127]

In the wake of *ECM* and *Walt Disney Co*., we are left to ponder where good faith fits into the fiduciary analysis. It would seem that, both in light of the allegations allowed to go to trial in *Disney*, and the allegations proven in *ECM*, conduct in conscious disregard for due care evidences of lack of good faith. The *ECM* court finds lack of good faith in behavior that it viewed to be "conscious disregard for fiduciary duties." Although the court discussed this lack of good faith in terms of both breach of good faith and a possible breach of the duty of loyalty, Muoio's liability was predicated on his approval of a transaction that he either knew or had strong reason to believe, due to his expertise, was unfair. This appears strikingly similar to the claims made in *Disney*, where lack of good faith appears to be an egregious lack of due care. Like the *Disney* directors, Muoio did nothing in a context where he should have used his expertise to review the transaction. This also sounds similar to the claims in *Smith v. Van Gorkom*,[128] where the directors were found grossly negligent for failing to obtain reasonably available information before approving a merger of the company. The difference between both the *ECM* and *Disney* claims when compared to *Smith v. Van Gorkom* appears to be the level of scienter. In *Disney*, the allegations were of absolute neglect of duties and *ECM* involved behavior in conscious disregard of duties. The culpable behavior in *Van Gorkom* involved a lesser degree of scienter – that of gross negligence. Yet in all three cases, the allegations were essentially that the directors did not do their homework by either thoroughly reviewing the contract (*Disney*) or ascertaining the true intrinsic value of the company (*ECM* and *Van Gorkom*). The genesis of all these claims thus seems to be lack of care.

The good faith requirement is still developing in corporate law and is now considered, at least by some commentators and courts, as fiduciary duty separate from care and loyalty.[129] Former 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."[130] 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."[131]

D. Coming Full Circle

While considering good faith as a separate fiduciary duty in its own right, Chief Justice Veasey finds that "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."[132] Interestingly, Chief Justice Veasey's articulation of the good faith standard sounds strikingly similar the words of Chief Justice Cardozo describing the duty of loyalty. As noted above, Chief Justice Cardozo framed the standard of behavior required by the duty of loyalty in terms of "Not honesty alone, but the punctilio of an honor the most sensitive. . . ."[133] Perhaps we have come full circle with the duties of loyalty and good faith.

It is possible to reconcile Chief Justice Veasey's remarks with the direction of the Delaware courts in *ECM* and *Disney.* First, to get beyond an exculpatory provision for a due care breach, the contested behavior must be more egregious than gross negligence, in essence, lacking in good faith. Failure to exercise good faith can be proven by conscious disregard of fiduciary duties (*ECM*), absolute neglect (*Disney*), or failure of honesty of purpose or not caring for the well-being of the fiduciary (remarks of Chief Justice Veasey.)

IV. ERISA's Fiduciary Standards

This Part begins by discussing the paradigmatic ERISA stock drop cases and their relationship to widely used employee benefit plans. It then turns to a brief discussion of ERISA's fiduciary duty of loyalty, which is derived from a complex statutory basis. Finally, the Part engages in a detailed evaluation of the application of the duty of loyalty in the ERISA stock drop cases.

A. 401(k) Plans and the ERISA Stock Drop Cases

Most employees who have a pension plan through their employer now are participants in what is known as a defined contribution plan.[134] Each employee has an individual account in the plan that enjoys favorable tax treatment and the assets in the account belong to the employee.[135] Typically these plans are 401(k) or KSOP accounts where each employee makes an individualized decision on making elective contributions to the plan, the employer may match some portion of the employee contributions, and each employee makes some or all of the decisions on investment of plan assets in the individual account.[136]

During the past few years these types of plans, which we refer to as employer-sponsored employee investment plans,[137] have been subject to considerable litigation because of their use of employer stock as a required or optional investment vehicle. The majority of 401(k)-plans sponsored by publicly held companies offer company stock as an investment option.[138] Employees are likely to hold assets, sometimes a substantial portion of their assets, in company stock in those plans. [139] The consistent fact pattern in the stock drop cases begins with a situation where some employees hold at least a portion of their plan account assets in employer stock. The employer stock drops in value. The employees who had invested in employer stock bring a class action alleging: (1) directors and others continued to offer company stock as a plan investment option, continued to make matching contributions in company stock, or continued to enforce plan rules prohibiting diversification out of employer stock at a time when the directors know or should have known that the stock was not a prudent investment option; (2) directors and others made materially inaccurate or incomplete disclosures regarding company stock; or (3) directors and others failed to meet their obligations in appointing and monitoring other plan fiduciaries. All three allegations raise issues involving the directors' fiduciary duty of loyalty.[140]

B. ERISA's Fiduciary Duty of Loyalty

Pension funds give rise to agency problems in ways that mirror the agency issues in corporate law. Regardless of the type of pension plan,[141] company officials, typically including members of the company's board of directors, oversee the plan and make critical decisions affecting the investment of assets or the available investment vehicles. Prior to the enactment of ERISA's extensive regulatory framework, fraud or underfunding of plans resulted in numerous situations where employees never received the benefits they expected.

During the 1960s the Senate Permanent Subcommittee on Investigations discovered the trustee of two union pension and welfare funds had arranged for several million dollars in plan funds to be moved to companies in Puerto Rico and Liberia. According to federal officials, no federal laws precluded the trustee's actions. Similarly, Jimmy Hoffa, former head of the Teamsters Union, was prosecuted for conspiracy and mail and wire fraud for the self-interested loans he received from a union pension fund. There was no pension-specific federal law that governed Hoffa's behavior.[142]

In reaction to these and other concerns about agency issues affecting pension plan governance and investments, the drafters of ERISA explicitly mobilized trust law standards and adopted them into a complex set of provisions governing the behavior of anyone who has discretion in administering or dealing with the assets of an employee-benefit plan. First, all pension plan assets must be held in trust.[143] Second, the statute establishes a counterpart to the trust law duty of loyalty, requiring fiduciaries to act "solely in the interest of the participants and beneficiaries and... for the exclusive purpose of... providing benefits to participants and their beneficiaries."[144]

After establishing a duty of loyalty, however, ERISA backtracks and explicitly permits fiduciaries to be conflicted by stating that the statute shall not be construed to "prohibit any fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest."[145] Arguably this departure from traditional trust law recognizes that employers have a special interest in the benefit plans they establish and may be reluctant to sponsor such plans if they are not permitted to retain a degree of control over the administration of the plans and investment of the plans.[146] Regardless of the reason for the provision permitting conflicted fiduciaries, the drafters of ERISA seemed to recognize the agency tensions inherent in the regime they were creating because they also absolutely prohibited a wide variety of transactions deemed to be "prohibited transactions." These provisions are broadly drawn to proscribe any transactions between a party in interest, including a fiduciary, and the plan.[147] ERISA's prohibited transactions provisions are so sweeping and potent that exceptions are necessary to permit normal activities, such as making reasonable payments to related parties for services.[148] Finally, in an additional protection for the plan participants and beneficiaries, ERISA prohibits the inurement of plan assets to the employer sponsoring the plan.[149]

Harmonizing the realities of conflicted fiduciaries with the anti-inurement and obligation of loyalty has not been simple, particularly given the variety of benefit plans governed by ERISA. A challenge for directors and other ERISA fiduciaries is to reconcile two lines of cases that flow from the conflicts of interest ERISA allows. One strand of law imposes absolute loyalty on fiduciaries, setting a standard of an "eye single" to the interests of plan participants and beneficiaries.[150] This strand is consistent with traditional trust law and Justice Cardozo's famous language in the state corporate law context that: "Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[151] The other strand recognizes that employers may receive "'incidental' and thus legitimate benefits . . . from the operation of a pension plan . . ."[152] This strand of the law is unique to ERISA and is compelled in part by the statute's approval of conflicted fiduciaries. It also recognizes that employers sponsor benefit plans, including company-sponsored employee investment plans, for a variety of self-interested reasons including decreasing employee turnover, competitive issues, and tax incentives.

Not only does ERISA depart from traditional trust law in its provisions for conflicted fiduciaries and specified prohibited transactions, it also defines who is a fiduciary in terms more sweeping than trust law. Trust law contemplates that the typical trust will be managed by a single or small number of trustees.[153] In contrast, ERISA contemplates numerous fiduciaries for each benefit plan. An individual may become an ERISA fiduciary by being named by the plan as a "named fiduciary" [154] or by having the functional responsibility that brings with it fiduciary status. Typically, an individual become functional fiduciaries by having discretion over the assets, administration, or management of a benefit plan or by providing investment advice for a fee to a plan.[155] Fiduciary status based on this functional definition, however, is limited "to the extent" the individual exercises or has discretionary authority over the functions that gave rise to the fiduciary status. Courts treat this question as a mixed question of law and fact.[156] Plaintiffs in some stock drop cases have successfully alleged that company directors are functional fiduciaries because they have some control over plan assets or because they appoint and monitor the actions of other plan fiduciaries.[157]

C. Specific Application of Duty of Loyalty in the ERISA Stock Drop Cases

The ERISA stock drop cases are at a particularly important point in the development of the fiduciary obligation of loyalty. Few of the cases have progressed past the summary judgment phase though most have permitted the plaintiffs to go forward at least on some claims.[158] At the same time, because of the litigation and potential liability involved with the use of company stock in employer-sponsored employee benefit plans, companies have begun to reconsider the use of company stock in the plans.[159] This section considers the fiduciary obligation of loyalty that inheres in such use of company stock in order to later contrast those obligations with directors' loyalty obligations to shareholders generally under corporate law.

1. Imprudence of Employer Stock as an Investment

One claim typically made in the ERISA stock drop cases is that fiduciaries did not amend the plan: (1) to eliminate company stock as an investment option; (2) to stop making the employer matches in company stock; or (3) to permit employees to diversify their plan accounts out of employee stock even though the stock had become an imprudent investment. The most obvious statutory claim in these instances may be that the fiduciaries who failed to reconsider the use of company stock in company-sponsored employee investment plans once that stock became a problematic investment choice violated their fiduciary obligations of prudence and due care. As an example, the court denied the fiduciaries summary judgment in *In re WorldCom, Inc. ERISA Litigation* where the plaintiffs had alleged the plan fiduciaries failed to fulfill their responsibilities to evaluate the continued availability of WorldCom stock as an investment alternative under the plan.[160]

The continued use of company stock, however, also may breach the fiduciaries' duty of loyalty. One claim raised repeatedly by plaintiffs is some variant of the allegation that the defendant fiduciaries were operating under a conflict of interest in their decisions on use of company stock in the plan because either their compensation was stock-based or they owned substantial amounts of company stock. In three cases before different judges in the Southern District of New York plaintiffs' claims of this type failed to survive motions to dismiss.

In *In re: Polaroid ERISA Litigation*, the court appeared to dismiss the conflict of interest claim on the basis that the existence of a compensation-based conflict was insufficient to establish a breach of loyalty.[161] The court in *In re: WorldCom, Inc. ERISA Litigation* was more explicit. The plaintiffs alleged that Bernard Ebbers, a WorldCom director as well as its President and CEO, breached his duty of loyalty by receiving stock-based compensation that created an incentive for him to keep the stock price high and ignore the best interests of plan participants and beneficiaries.[162] The court rejected the claim, relying on both ERISA's explicit provision for conflicted fiduciaries and its limitation of liability to only those acts taken while in the role of ERISA fiduciary.[163] The plaintiffs had not shown that the conflict of interest caused Ebbers to act other than in the best interests of plan participants and beneficiaries when making decisions as a plan fiduciary.[164] In *In re: AOL Time Warner, Inc. Securities and "ERISA" Litigation*, the court took a slightly different approach to a similar claim – that directors had sold their company stock while continuing to offer the stock as a plan investment.[165] The court ruled that the directors' personal stock sales of nonplan stock could not be considered a fiduciary act under ERISA because the sales were not undertaken as part of their administration or investment of the plan assets.[166] As only functional fiduciaries, the directors could not have liability under ERISA for acts taken outside their functional fiduciary role.[167]

In contrast, the district court in *In re: Honeywell International ERISA Litigation* permitted plaintiffs' breach of loyalty claim premised on a compensation-based conflict of interest to go forward.[168] Defendants argued that ERISA's provisions for conflicted fiduciaries protected them and that participation in stock-based compensation programs is not sufficient to state a breach of loyalty claim.[169] The court agreed with both arguments but declared the defendants could "still be held liable for disloyalty if they acted in their own interests or the Company's, and against the interests of the Plan, while performing fiduciary duties."[170] The court had already decided that plaintiffs had adequately alleged both misrepresentation of the company's financial position[171] and failure to change the availability of company stock in the plan after the stock became an imprudent investment.[172] These alleged actions were sufficient to indicate the fiduciaries had acted in their own or Honeywell's best interest while performing their fiduciary obligations.[173] Similarly, plaintiffs' claim of conflict of interest survived a motion to dismiss in *Hill v. BellSouth Corp.*[174] The court found sufficient plaintiffs' allegations that defendants' participation in a stock-based compensation plan gave them an incentive to maintain the price of company securities and that two defendants, including the chair of the Board of Directors, had personally sold company stock during the class period.[175] The *BellSouth* court did not articulate the standard it ultimately will use to determine whether the defendants breached their duty of loyalty nor did it explicitly recognize ERISA's provision for conflicted fiduciaries.[176] But, the court's statement that plaintiffs had alleged that defendants "acted in a way that benefited them personally, yet did not protect the trust"[177] may indicate that the fiduciaries' personal benefit will be important in the final determination.

An argument with subtle differences is that fiduciaries in the stock drop cases have breached their duty to avoid conflicts of interest without specifying any particularized conflicts. The tension in these claims lies in determining the boundary between the statutory provision permitting conflicted fiduciaries[178] and a Supreme Court opinion that listed the "avoidance of conflicts of interest"[179] as being among the duties of an ERISA fiduciary. In *In re: Dynegy, Inc. ERISA Litigation*, the plaintiffs argued that the fiduciaries should have hired an independent fiduciary to determine the prudence of company stock as an investment or notified the Department of Labor (DOL) of the circumstances that made company stock imprudent.[180] Plaintiffs relied on Fifth Circuit precedent that "[T]he presence of conflicting interests imposes on fiduciaries the obligation to take precautions to ensure that their duty of loyalty is not compromised . . . 'The level of precaution necessary to relieve a fiduciary of the taint of a potential conflict should depend on the circumstances of the case and the magnitude of the potential conflict.'… In some instances, the only open course of action may be to appoint an independent fiduciary."[181] The *Dynegy* court dismissed plaintiffs' claim for failing to identify specific conflicts of interest and the harm those conflicts caused.[182] In *Pennsylvania Federation v. Norfolk Southern Corp.*, plaintiffs alleged that defendants violated their duty of loyalty by continuing to make matching contributions in plan stock and precluding diversification in order to inflate the price of the stock while the company's financial performance was poor.[183] The court held that defendants could not have violated their obligation of loyalty because they had followed the plan's terms regarding the investment of matching contributions.[184]

In a decision contrasting with those of *Dynegy* and *Norfolk Southern*, the court in *In re: Electronic Data Systems Corp. "ERISA" Litigation* denied a motion to dismiss on what looks to be a nearly identical claim – that because the fiduciaries operated under a conflict of interest they should have engaged an independent fiduciary or otherwise eliminated the conflict.[185] Although plaintiffs had not argued the fiduciaries' conflict resulted from stock-based compensation, the defendants contended that ERISA permits fiduciaries to take part in such compensation programs.[186] The court rejected this defense as an "attempt to place un-pled factual restrictions"[187] on the plaintiffs' claim. The court gives no hint as to whether the plaintiffs must ultimately prove direct benefit to the defendants at the plan's expense and does not otherwise discuss the standard for evaluating the plaintiffs' claim.[188]

Finally, a quite different breach of loyalty claim may be predicated on the argument that a conflicted fiduciary must reconsider the use of company stock in a plan even though the plan terms require the use of such stock. In what is known as the settlor doctrine, the Supreme Court has determined that ERISA actors do not act in an ERISA fiduciary role when establishing, amending, or terminating a benefit plan.[189] Defendants have argued that, where the terms of the company-sponsored employee investment plan require the use of employer stock, the settlor doctrine protects them from having to reconsider the use of such stock and from any liability in failing to evaluate the stock's appropriateness as an investment alternative.[190] Courts have split over the extent to which the doctrine actually protects ERISA fiduciaries in such situations but even where the fiduciaries have an obligation to reconsider the use of company stock the courts typically accord them a presumption of prudence. The presumption in favor of the fiduciaries recognizes the policy considerations favoring the use of company stock and the liability a fiduciary might face by being overly cautious in revoking the use of company stock.[191]

In *Honeywell,* however, the court noted that the combination of a fiduciary's "conflicted status," knowledge of the impending collapse of a company, and a "precipitous decline in the price of employer stock"[192] could be sufficient to overcome the fiduciary's presumption of prudence. The courts have not articulated the value of the conflicted fiduciaries obtaining an opinion from an independent fiduciary nor have they articulated a standard for evaluating the use of company stock when the determination is made by an independent fiduciary. Elsewhere we have suggested that stricter scrutiny is appropriate in situations, such as the use of company stock, that present inherent conflicts of interest and that one way to minimize those conflicts would be through the use of independent fiduciaries.[193]

2. Failing to Properly Appoint or Monitor Plan Fiduciaries

Courts generally agree with the DOL's view that appointing plan fiduciaries is itself a fiduciary function and it includes a fiduciary obligation to monitor the appointed fiduciaries.[194] Plaintiffs who allege wrongdoing associated with investments in company stock frequently allege that corporate directors and others 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. The claims can implicate the duties of prudence and care but some are filed as claims for breach of duty of loyalty.

Plaintiff's contentions in *Howell v. Motorola, Inc.*[195] illustrate the complexities in these claims. The plaintiff alleged that defendants who were directors of Motorola breached their fiduciary duty, presumably the duty of loyalty, by failing to appoint plan fiduciaries who were independent and thus who were "'influenced or controlled by the tacit or explicit direction of Motorola and/or the Director Defendants with respect to the management, investment and-or proposed or actual disposition of Plan assets."[196] The perceived lack of independence appeared to be grounded entirely in the fact that the fiduciaries in question were employees of Motorola.[197] The court was troubled that the claim appeared inconsistent with ERISA's provision permitting employees to act as fiduciaries but decided it did not yet need to reach the issue since the court found the plaintiff's failure to monitor claim sufficient to survive the motion to dismiss.[198]

The director defendants had argued that they had no obligation to monitor those fiduciaries directly responsible for selecting plan investment vehicles and participant communications. They contended that the duty of monitoring only arises where fiduciaries appoint "'close business associates'"[199] so that the lower level fiduciaries have "'clear conflicts of interest beyond their assumed loyalty to their employer…'"[200] Although it acknowledged some limited contrary authority,[201] the court found persuasive the DOL position and clear weight of decisional authority that fiduciaries have an obligation to monitor the fiduciaries they appoint.[202]

3. Material Misstatements and Omissions

Among its many provisions in addition to fiduciary regulation, ERISA sets forth specific disclosure obligations requiring plans to provide information to plan participants and beneficiaries and the DOL.[203] There is some trend in the ERISA case law to find that benefit plan fiduciaries have some disclosure obligations even beyond those explicitly established in the statute and regulation.[204] Courts have developed this theory of expanded disclosure by looking to traditional trust law, which requires a fiduciary who knows particular information would be of interest and value to a beneficiary to communicate that information.[205]

Plaintiffs in the ERISA stock drop cases frequently allege plan fiduciaries have made or permitted to be made misstatements or omissions about the company's financial status and prospects and those misstatements or omissions affected the plaintiffs' purchase or sale decisions.[206] The duty to avoid conflicts of interest raised in the *Electronic Data Systems* case and discussed above also refers to the fiduciaries obligation to make appropriate disclosures to plan participants and beneficiaries.[207] Plaintiffs tie together the disclosure obligation, the duty of loyalty, and its alleged breach by arguing that as fiduciaries and "corporate officers they had both an incentive to conceal unknown information about EDS' stock value and a duty to reveal that information to Plan beneficiaries."[208] The allegation survived defendant directors' motion to dismiss.[209]

VI. The Developing Duty of Loyalty

The corporate scandals of the late 1990s, the resulting public attention to corporate wrongdoing, the financial losses workers experienced in their 401(k)-style accounts, and the enactment of the Sarbanes-Oxley Act[210] have increased the scrutiny on corporate directors. Commentators have observed the pressure brought to bear on Delaware corporate law to retain its position as the primary regulator of director responsibility to shareholders.[211] The many cases brought challenging fiduciary decisions on the use of company stock in company-sponsored employee investment plans are forcing the federal courts to address those obligations in the context of ERISA.[212]

As a result of these pressures, jurisprudence on the duty of loyalty is developing in parallel in Delaware interpreting traditional state corporate law principles and in the federal courts interpreting the statutory obligations imposed by ERISA. The concepts underlying the development of the duty of loyalty in these two fields are strikingly similar. Both fields trace their imposition of a loyalty obligation to the duty of loyalty established under trust law. Although the application of the duty of loyalty is much broader in both fields, they share the need to apply the duty of loyalty when fiduciaries make decisions regarding company stock. In corporate law, for example, that obligation becomes important when a corporation is buying out minority shareholders or making decisions on merger and acquisition transactions. In ERISA the use of employer stock as an investment vehicle and a source of matching contributions for company-sponsored employee investment plans poses numerous loyalty considerations.

In this Part we consider recent developments in the fiduciary duty of loyalty in Delaware corporate law and in federal law under ERISA. The continued shaping of loyalty doctrine raises critical questions, particularly for corporate directors, who may be fiduciaries under both Delaware corporate law and ERISA. In what situations are directors considered to have a conflict of interest that matters for purposes of the duty of loyalty? What standards should be used to evaluate whether directors have violated the obligation of loyalty? What distinctions are developing between Delaware state law and federal law under ERISA? Are any diverging approaches, overlaps, or tensions firmly grounded in principle and not such that they impose inconsistent obligations on directors? This Part begins by considering the nature of conflicts of interest. It then turns to the standards used to determine whether a loyalty violation has in fact occurred.

A. Identifying Conflicts of Interest

The initial consideration in analyzing the duty of loyalty should be whether an individual is acting under a conflict of interest. That, in turn, gives rise to two subordinate issues. First, if a conflict exists, is it the type of conflict or a significant enough conflict that it should be relevant for a duty of loyalty analysis? Second, is a conflict of interest a necessary prerequisite to a violation of the fiduciary duty of loyalty?

Beginning with the question of types or significance of conflicts of interest, theoretically, an individual's mere status as a corporate director could create a conflict of interest because directors receive fees from the company for their service and the prestige associated with such a position may be generally career enhancing. However, treating every director as conflicted in every corporate transaction would effectively nullify the business judgment rule, decrease directors' risk tolerance for transactions, burden the court system, and discourage individuals from accepting directorships. For ERISA purposes, the statute's provision explicitly allowing officers, employees, and agents to serve as fiduciaries would be inconsistent with imposing an extensive loyalty compliance analysis on each plan-related decision made by such a fiduciary. Clearly, for both Delaware corporate law purposes and federal ERISA purposes, the bar for a conflict of interest that gives rise to fiduciary scrutiny must be set higher than mere status as a corporate director.

The Chancery court in *ECM* speculated that a loyalty breach may require the director to have "a self-dealing conflict of interest in the transaction itself."[213] This standard, if in fact adopted by Delaware, would establish a significant threshold for when conflicts rise to the level of requiring that transactions be scrutinized for loyalty violations. The court's language appears to require a two-part inquiry. Plaintiffs presumably would need to establish both that the conflict resulted in self-dealing and that the self-dealing was part of the transaction in question. Self-dealing might be thought to include any benefit the subject director would ultimately receive other than retention of the directorship. If the director derived the benefit as a result of a vote on or other involvement with a transaction, then the benefit could give rise to a conflict that would fit within the court's language.

A careful examination of the *ECM* court's application of its articulated standard implies, however, that it contemplates the possibility of a higher bar for conflicts. The court believed that Raynor voted to approve the price of $10.25 per share to avoid opposing Prosser because "Raynor's economic interests were tied solely to Prosser and he acted to further those economic interests."[214] In the very next sentence the court holds that Raynor violated his duty of "loyalty and/or good faith"[215] and attributed its inconclusiveness to its concern that Delaware law might require "a self-dealing conflict of interest in the interest in the transaction." [216] If that is the standard for a loyalty violation, the court believed that Raynor would not have violated his duty of loyalty. The only way to understand the court's analysis is that either the personal "economic interests" Raynor had acted to further by his vote did not constitute "self-dealing" or the self-dealing was not derived directly enough from the transaction. It appears that the court's concern was the latter. By its statement that "Raynor did not benefit directly from the transactions,"[217] the court indicates that a financial quid-pro-quo to Raynor in return for his vote in favor of the $10.25 share price transaction does not sufficiently become part of the transaction to require enhanced scrutiny to check for a violation of his duty of loyalty.

Understood in this way, the court's analysis is troubling. It appears that if Raynor had owned ECM stock and benefited financially from the unfairly low purchase price imposed on the minority shareholders, then Raynor's benefit would meet both the self-dealing requirement and the need for the self-dealing to be "in the transaction itself."[218] It seems appropriate that minority shareholders receive the protection of enhanced scrutiny for compliance with a director's duty of loyalty when the director financially benefits in such a direct way. But, the actual facts also could cause significant loyalty concerns to ECM's minority shareholders. If Raynor in fact derived significant economic gain, or avoided a significant economic harm, as a quid-pro-quo for his vote in favor of the $10.25 share price transaction then it does not seem as though the minority shareholders would care that the financial benefit, or avoidance of loss, came from a source other than Raynor's stock ownership in ECM. Either way, his personal financial interests caused Raynor to vote for a transaction that the court found was not fair to the minority shareholders. The source of the funds giving rise to the conflict of interest does not reduce the risk to the minority shareholders, nor does it differently implicate the underlying agency concern – that trustees operating under personal conflicts of interest will all too often neglect the best interests of the beneficiary in favor of the trustee's own interests[219] -- which initially gave rise to the development of the duty of loyalty in trust law.

Consider the implication of the *ECM* analysis for ERISA stock drop cases. One typical allegation is that directors and other fiduciaries violated their duties by permitting the continued use of company stock as a voluntary or mandated investment vehicle or the use of company stock as the employer's matching contribution. The courts have not developed a coherent approach for evaluating when a director violates the duty of loyalty in such cases and the corporate law jurisprudence provides one potential source for the development of ERISA doctrine.

The notion that a loyalty breach might exist only where the director had a "self-dealing conflict of interest in the transaction itself" arguably bears a superficial parallel to the benefit case law indicating that fiduciaries only have fiduciary obligations to the extent they act as fiduciaries. The traditional import of this well-developed doctrine is to protect fiduciaries from liability when making business decisions that cause harm to the interests of benefit plan participants or beneficiaries and in circumstances where the fiduciaries make settlor decisions about the plan. As an example of the former situation, the fiduciaries might make a poor business decision that causes the company's profits to drop and, thus, reduces the company's contribution to an ERISA profit sharing plan. The poor business decision harmed the ERISA plan participants and beneficiaries but would not give rise to any kind of ERISA fiduciary violation because the directors did not make the business decision in their capacity as ERISA fiduciaries.

A blind application of the 'transaction itself' standard, however, could lead to the sort of nonsensical analysis performed by the district court in *In re: AOL Time Warner, Inc. Securities and "ERISA Litigation.*[220] Assume directors of Company A sell their personal Company A stock and, at the same time, continue unchanged the use of Company A stock in the company-sponsored employee investment plan as an optional investment vehicle and as the company's matching contributions. Assume also that the directors do not participate, as outside directors typically would not, in the plan. Instead, the directors' Company A stock holdings are held in personal accounts unaffiliated with any company-sponsored plan. Assume, finally, that the directors, in fact, decided not to make any change to the plan's use of Company A stock and not to communicate concerns with participants or beneficiaries solely because the directors wanted to support the price of Company A stock while they sold their own holdings. Such a scenario raises egregious duty of loyalty concerns.

Whether application of the *ECM* court's logic and the "self-dealing conflict in the transaction itself" standard to the foregoing situation would result in any liability to the directors under ERISA for a breach of the duty of loyalty, however, depends on how the "transaction itself" requirement is interpreted. Like Raynor, the directors enjoyed a personal benefit – here from their sale of their own Company A stock. There are two transactions that one might look at for the "transaction itself:" (1) the personal sale of the Company A stock; or (2) the plan-related decision. The *AOL Time Warner* court focused on the directors' sales of their personal securities as the transaction in question and dismissed plaintiffs' loyalty claims because directors do not act as plan fiduciaries when they sell their own non-plan stock.[221]

The true basis of the *AOL Time Warner* plaintiffs, however, should not have been viewed as an ERISA violation and loss because the directors sold their own securities, instead the alleged violation and loss resulted from the decision with respect to the continued use of company stock in the plan.[222] Similarly, in the hypothetical Company A situation, the "transaction itself" that would seem to matter would be the decision to not change the plan's use of Company A stock and not to communicate concerns regarding the stock with the plan participants and beneficiaries. But, applying the same logic to these directors as the *ECM* court applied to Raynor, the directors did not own any stock held by the plan. Therefore, one possible analysis is to determine that any financial interests they enhanced through their decision on the use of plan stock and communications did not derive from the "transaction itself" – the transaction being the plan's continued use of company stock. An alternative approach that would distinguish the *ECM* situation and find a sufficient conflict in the Company A situation, would be to focus on the directors' ownership of Company A securities. Because their self-dealing gains derived from Company A securities and the transaction – the decision regarding plan use of Company A securities and communication – related directly to Company A securities, the relationship between the gain and the transaction could be direct enough to support a finding of a conflict of interest. In a situation, as occurred in a number of the actual ERISA stock drop cases discussed above, where the directors gains were derived from stock-based compensation,[223] the analysis would seem to be substantially similar to that in the Company A hypothetical and a finding of a conflict of interest, would in the same way, depend on the application of the *ECM* court's analysis.

If, as an alternative to requiring a self-dealing conflict in the transaction at issue, the courts also recognize that a substantial lack of independence requires enhanced scrutiny to ensure a fiduciary has complied with the duty of loyalty, that would resolve the potential problems established by the *ECM* court in Delaware corporate law and in the federal law of ERISA. In the circumstances of *ECM*, both Raynor and Muoio had relationships with Prosser and ECM going well beyond their status as directors and giving rise to concerns of lack of independence. That lack of independence would have been sufficient, under the reasoning of the courts in *Orman* and *Hollinger*, to give rise to a violation of the duty of loyalty. Similarly, where ERISA fiduciaries lack independence by having significant company share ownership or stock-based compensation, then that lack of independence should give rise to enhanced scrutiny that the fiduciaries' stock-related plan decisions comply with their duty of loyalty.

In sum, both Delaware corporate law and the federal law of ERISA incorporate the fiduciary obligation of loyalty in order to prevent self-interested fiduciaries – for our purposes corporate directors -- from acting to their own advantage and to the detriment of the shareholders or plan members. In order to protect against that misuse of power and personal profit, the determination of what constitutes a conflict of interest must be sensitive enough to result in scrutiny of transactions where fiduciaries are subjected to those temptations. At the same time, the definition must be selective enough to recognize that some tangential benefit may flow to corporate directors simply as a result of their position and the realities of business practice and good corporate governance requires some level of compromise and collegiality.

B. The Duty of Loyalty Analysis

If one or more directors operated under a conflict of interest that is significant for duty of loyalty purposes, the next problem is to determine the standard to be applied to determine whether the director breached the duty of loyalty. This section compares Delaware corporate law's entire fairness standard to the approach in the ERISA stock drop cases.

Indications have long existed in case law and from commentators that a corporate action taken by a board operating under a conflict of interest would be subject to an entire fairness standard. After finding the existence of a conflict of interest the burden of proof would shift to the conflicted directors to convince the reviewing court that the transaction was both substantively fair and that the board followed a fair process in approving the transaction. If the directors did not meet their burden of proof in either prong of the analysis, the court would find a breach of the directors' duty of loyalty.[224]

In addition to raising the question of what constitutes a conflict of interest for duty of loyalty purposes, the *ECM* court's analysis was unusual in the way the court approached the entire fairness analysis. Instead of approaching the conflict question first, the court began its inquiry by evaluating the stock purchase for the fairness of its price and the procedure used by the board. Following a detailed review of the company's financial position and prospects, the court determined that the $10.25 price was too low and a fair value would have been $30.05. Under the traditional approach where either substantive unfairness or procedural unfairness would be enough to establish a violation the court could have ended its analysis here. It continued though and evaluated a variety of factors to determine whether the directors used a fair procedure in establishing and conducting the stock transaction. The court held that the board's action did not meet the fair dealing standard. Only after finding the transaction did not meet either the fair price or the fair dealing standard did the court turn to determining the liability of individual directors. ECM's exculpation provision required the court to determine whether any directors violated more than their duty of care. This is where the court made the holdings, some in the alternative, on violations of loyalty and good faith that we discussed in the last section.

As mentioned above, the *ECM* court consolidated a statutory appraisal action with the class action for breach of fiduciary duty. This may explain why the court analyzed the fairness of the price before undertaking the fiduciary analysis. Regardless of whether the court found a breach of fiduciary duty, the appraisal action would require the court to make a determination on fair price.

The *ECM* court's discussion of the applicable burden of proof is in accord with traditional duty of loyalty doctrine. As noted by the court, "because the defendants stood on both sides of the transaction, normally the burden of proof would fall upon them."[225] However, if the defendants could prove that "the transaction was approved by a fully functioning independent committee of independent directors, or by an informed majority of minority stockholders, the burden shifts to the plaintiff to prove that the transaction was unfair."[226] Here, the court held that the burden of proof remained with the defendants.[227] It stated that "the merger was not approved by a committee of independent directors who were properly informed or independent of Prosser, nor was it approved by an informed vote of a majority of ECM's minority stockholders."[228]

The standard used in the ERISA stock drop cases contrasts sharply with the shifting burden of proof and two-pronged standard typically used in Delaware corporate law once a conflict of interest is shown. Instead of having the burden of proof and needing to survive both parts of a two part scrutiny, at worst ERISA fiduciaries defend against the claims of plaintiffs who appear to retain the burden of proof to show fiduciaries acted in their own interests rather than in the interest of plan participants and beneficiaries. At best, the ERISA fiduciaries enjoy a presumption in favor of their decision to use and continue the use of employer stock in a company-sponsored employee investment plan. This presumption is traceable to *Moench v. Robertson*, an Employee Stock Ownership Plan (ESOP) case from the Third Circuit.[229] According to *Moench*, fiduciaries enjoy 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 [in the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.'"[230] In a further refinement, it appears that, at least in some jurisdictions, ESOP plaintiffs must prove that "the company is on the brink of collapse or undergoing serious mismanagement"[231] in order to rebut the *Moench* presumption. ESOPs differ from the 401(k) plans that typify the ERISA stock drop cases because ESOPs are statutorily required to invest primarily in employer stock whereas no such provision exists for 401(k) plans. Courts deciding ERISA stock drop cases could have distinguished *Moench* on this basis, but multiple courts have applied the *Moench* presumption when analyzing a 401(k) plan fiduciary's prudence.[232] While the *Moench* presumption only explicitly governs the duty of prudence, not loyalty, its strength could help explain the skepticism with which some courts have approached plaintiffs' loyalty claims.

To further develop the ways in which Delaware corporate law and the federal law of ERISA depart in their evaluation of directors' duty of loyalty in transactions involving company stock, consider the following hypothetical. Assume that a group of directors is operating under a conflict of interest so serious as to meet whatever standard is required to cause a court to examine whether the directors breached their duty of loyalty. Assume also that the transaction in question involved a transaction in company stock between the corporation and employees. If the transaction occurred outside an ERISA-regulated employee benefit plan, the directors' conduct would be evaluated by Delaware corporate law. The directors would bear the burden of proving the stock price was fair and the transaction was fair as to process. If, on the other hand, the transaction occurred inside an ERISA-regulated plan, the directors would likely receive the *Moench* presumption that their actions met their duty of prudence. At worst directors may need to defend against plaintiffs who bear the burden of proof to show that the directors in fact acted in their own interests and contrary to the interests of the participants and beneficiaries.

The dramatic difference between the evaluative standards used by Delaware corporate law and federal law in the ERISA stock drop cases cannot be explained by differential theoretical underpinnings of the two doctrinal areas – both trace their development and application of the duty of loyalty to traditional trust law. Perhaps the explanation for the difference lies in ERISA's explicit provision for conflicted fiduciaries whereas corporate law encourages decisions by disinterested directors by providing those directors with the benefit of the business judgment rule and, in turn, subjecting interested directors to the enhanced scrutiny of the entire fairness rule. Another distinction militating in favor of some sensitivity in the standard for ERISA fiduciaries are the provisions in ERISA and the Internal Revenue Code that favor the use of company stock in benefit plans. It would be troubling for federal law to encourage the use of company stock in benefit plans and then to always subject the plan's fiduciaries to enhanced scrutiny in determining whether they met their fiduciary duty of loyalty when making company stock-related plan decisions.

Legitimate reasons, then, exist for utilizing different standards to evaluate whether directors have met their fiduciary obligation of loyalty in Delaware state corporate law contexts and in the federal law under ERISA. However, neither area should lose track of the concern that gave rise to the use of a duty of loyalty in these contexts. Fiduciary directors who enjoy the power to act in transactions where their personal interests conflict with the interests of the shareholders or plan participants can be expected to be sorely tempted to – and many will – act in their own best interests.

We believe the *ECM* court misconstrued the law in Delaware when it worried that a breach of loyalty requires the fiduciary in question to "have a self-dealing conflict of interest in the transaction itself."[233] The Supreme Court of Delaware has never set forth such a stringent standard for determining the existence of a conflict of interest. The acceptance of such a standard would permit many fiduciaries to enjoy substantial indirect gains in return for supporting transactions not in the best interest of the shareholders while technically not giving rise to a conflict of interest. To the extent existing Delaware jurisprudence calls for entire fairness scrutiny only after a finding of a conflict of interest, the standard could immunize from any significant review numerous transactions where fiduciaries profit indirectly. Applying, as an alternative route to enhanced scrutiny for compliance with the fiduciary duty of loyalty, an analysis of whether the fiduciary was independent in the transaction at issue would more appropriately protect against the temptations of fiduciary self-interest.

Given the acceptance of certain conflicts in ERISA and the federal policy favoring the use of company stock in 401(k)-style plans, it is inappropriate to automatically shift the burden of proof in all of the ERISA stock drop cases to the plan fiduciaries simply because they are acting under an inherent conflict of interest. Elsewhere, however, we have advocated serious court scrutiny of the circumstances in which employer stock is used in company-sponsored employee investment plans.[234] We also suggested that ERISA fiduciaries be encouraged to minimize their conflicts in the use of employer stock, for example by engaging independent fiduciaries.[235] Similarly, if ERISA fiduciaries have a conflict of interest that exceeds the standard conflict authorized by the statute, then the level of scrutiny for compliance with the fiduciaries' duty of loyalty should increase. For example, if ERISA fiduciaries sell substantial amounts of company stock in what appears to be recognition of the company's changed circumstances, thereby profiting at the same time they leave unchanged the plan's use of company stock and fail to make cautionary disclosures to plan participants and beneficiaries, the fiduciaries decision-making, or lack thereof, regarding the plan should be subjected to serious scrutiny. At some point it will be appropriate for the fiduciaries to bear the burden of proof on compliance with their duty of loyalty, as do seriously conflicted fiduciaries in both corporate law and trust law.

V. Conclusion

The fiduciary duty of loyalty plays a critical role in protecting the integrity of trusts, the capital structure of corporations, and the involvement of employers in the benefit plans they sponsor by ensuring that those with power over trust assets, corporate funds, and benefit plan decision-making are not tempted to profit at the expense of those they serve. As the duty of loyalty jurisprudence continues to develop during the current era of recovery from corporate law scandal and of sensitivity to employees who have seen their retirement dreams fade along with their 401(k) account balances, the result cannot be one that holds fiduciaries liable for merely being fiduciaries. It appears, however, that the courts at both the state and federal level may be in danger of swinging the pendulum too far in the opposite direction. Fiduciary analysis has always been flexible in an effort to protect the relatively powerless from the self-dealing of those they have trusted to act on their behalf. The goal should not be to develop an arbitrary, bright-line approach that relies on a particularized type of conflict of interest. Instead, the courts would do well to keep in mind the appropriately famous and enduring words of Chief Justice Cardozo: "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."[236]

Footnotes

[1] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).
[2] *Id.*

[3] In re: Emerg. Commun., Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004). The case is best known because one director with substantial expertise in finance and the telecommunications sector was held, at least in part because of that expertise, to have violated his duty to shareholders. Harvey L. Pitt, *The Changing Standards by Which Directors Will Be Judged*, 79 ST. JOHN'S L. REV. 1 (Winter, 2005); E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163, 172 (2004).

[4] 2004 Del. Ch. LEXIS 70, at *142 n.184.

[5] Employee Retirement Income Security Act (ERISA), of 1974 §§ 1-4402, 29 U.S.C. §§ 1001-1461 (2000).

[6] 2004 Del. Ch. LEXIS 70.

[7] RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959) (hereinafter RESTATEMENT). Trust law imposes an array of other obligations on trustees in addition to loyalty. Prudence is required of trustees in both the investment of trust assets and in the administration of the trust. The trustee generally must follow any specific instructions set forth by the trust. The trustee also must provide the beneficiaries with information regarding the trust property. Dana M. Muir, *Fiduciary Status As an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391, 396 (2000).

[8] RESTATEMENT, *supra* note 7, at § 183 ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

[9] John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 939 (2005).

[10] *Id.* at 931.

[11] *Id.* at 934.

[12] *Id.* at 963-79.

[13] *Id.* at 933-34.

[14] *See, e.g.,* Alessi v. Beracha, 849 A.2d 939, 950 (2004) "[f]iduciary duties are owed by the directors and officers to the corporation and its stockholders") (quoting Arnold v. Soc'y for Sav. Bancorp., 678 A.2d 533, 539 (Del. 1996)); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 931 (Del. 2003); Paramount Comm. v. Viacom, Inc., 637 A.2d 34, 43 (Del. 1994); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); 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* WILLIAM E. KNEPPER ET AL., LIABILITY OF CORPORATE OFFICERS AND DIRECTORS §1.07 (9th ed. 2003); D. Kyle Sampson, *The Fiduciary Duties of Corporate Directors to "Phantom" Stockholders,* 62 U. CHI. L. REV. 1275, 1276 (1995); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); J.C. SHEPHERD, THE LAW OF FIDUCIARIES (1981); *but see* John C. Carter, *The Fiduciary Rights of Shareholders*, 29 WM. & MARY L. REV. 823, 923 (1988) ("Although courts commonly speak of a fiduciary duty of directors to the corporation and its shareholders, one is hard pressed to find a case in which directors are held directly liable to shareholders, absent circumstances that create a special relationship.").

[15] 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).

[16] *See* sources cited *infra* notes 121-133 and accompanying text for a discussion of the obligation of good faith.

[17] *See, e.g.,* 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.

[18] *See* 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, 610 (1984).

[19] 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 paragraph 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.

DEL. CODE ANN. tit. 8, § 102(b)(7) (2004).

[20] The following statutes are similar to Section 102(b)(7) in Delaware: ALA. CODE. § 10-2B-2.02(3) (Michie 2004); ALASKA STAT. § 10.06.210(1)(N) (Michie 2004); ARIZ. REV. STAT. § 10-202(B) (2004); ARK. CODE ANN. § 4-27-202(b)(3) (2003); CAL. CORP. CODE § 204(a)(10) (Deering 2004); GA. CODE ANN. § 14-2-202(b)(4) (2004); IDAHO CODE §

30-1-202(2)(d) (Bender 2004); 805 ILL. COMP. STAT. 5/2.10(b)(3) (Bender 2004); IOWA CODE ANN. § 490.832 (2003); KAN. STAT. ANN. § 17-6002(b)(8) (2003); KY. REV. STAT. ANN. § 271B.2-020(2)(d) (Michie 2004); LA. REV. STAT. ANN. § 12:24(c)(4) (West 2004); MASS. ANN. LAWS ch. 156B § 13(b)(1 ½) (West 2004); MICH. COMP. LAWS § 450.1209(c) (2004); MINN. STAT. ANN. § 302A.251(b)(4) (LexisNexis 2003); MO. ANN. STAT. § 351.055(9) (2004); MISS. CODE ANN. § 79-4-2.02(b)(4) (2004); MONT. CODE ANN. § 35-1-216(2)(d) (2004); NEB. REV. STAT. ANN. § 21-2018(2)(d) (2004); N.M. STAT. ANN. § 53-12-2(E) (Michie 2004); N.Y. BUS. CORP. LAW § 402(b) (Consol. 2004); N.C. GEN. STAT. § 55-2-02(b)(3) (2004); N.D. CENT. CODE § 10-19.1-50(5) (2003); OKLA. STAT. tit. 18, § 1006(B)(7) (2004); OR. REV. STAT. § 60.047(2)(d) (LexisNexis 2003); R.I. GEN. LAWS § 7-1.1-48(a)(6) (2004); S.C. CODE ANN. § 33-2-102(e) (Law. Co-op. 2003); S.D. CODIFIED LAWS § 47-2-58.8 (2004); TENN. CODE. ANN. § 48-12-102(b)(3) (2004); TEX. REV. CIV. STAT. ANN. art. 1302-7.06(B) (2004); VT. STAT. ANN. tit. 11A, § 2.02(b)(4) (2004); W. VA. CODE ANN. § 31D-2-202(4) (Michie 2004); WYO. STAT. ANN. § 17-16-202 (Michie 2004). The following statutes also provide liability protection for officers: LA. REV. STAT. ANN. § 12:24(c)(4) (2004); ME. REV. STAT. Tit. 13-C, § 202; MD. CODE ANN., CORPS, & ASS'NS § 2-405.2 (2003); NEV. REV. STAT. § 78.138(7) (2004); N.H. REV. STAT. ANN. § 292:2(V-a) (2004); N.J. STAT. ANN. § 14A:2-7(3) (LexisNexis 2004); VA. CODE ANN. § 13.1-692.1 (Michie 2004). Exculpation is provided automatically by FLA. ANN. STAT. § 607.0831 (2004); IND. CODE § 23-1-35-1(e) (Burns 2004); Me. Rev. Stat. Ann. tit. 13, § 202 (2003); OHIO REV. CODE ANN. § 1701.59(c) (Page's 2004). Wisconsin automatically provides for exculpation, unless the corporation provides otherwise. WIS. STAT. ANN. § 180.0828 (2003). The following statutes permit exculpatory language in the corporate bylaws. HAW. REV. STAT. § 414-32(5) (Michie 2003); UTAH CODE ANN. § 16-10a-841(1) (Bender 2004); VA. CODE ANN. § 13.1-692.1 (Michie 2004).

[21] In re Emerg. Commun., Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004).

[22] *Id*.

[23] *Id*. at *2.

[24] *Id.* at *3.

[25] *Id.* at *2.

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

[27] 2004 Del. Ch. LEXIS 70, at *35-36.

[28] *Id.* at *36.

[29] *Id.* at *43-101.

[30] *Id.* at *85.

[31] *Id*. at *81.

[32] *Id.* at *101.

[33] *Id.* at *102.

[34] *Id*. at *103 (citing Emerald Partners v. Berlin, 787 A.2d at 94 (quoting Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1165 & n. 16 (Del. 1995))).

[35] 2004 Del. Ch. LEXIS 70, at *104.

[36] *Id.*

[37] *Id.* at *116 (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985).

[38] 2004 Del. Ch. LEXIS 70, at *137.

[39] *Id.* at *14.

[40] *Id.* at *18.

[41] *Id.* at *116-18.

[42] *Id.* at *14

[43] *Id.* at *22.

[44] *Id.* at *118-19.

[45] *Id.*

[46] *Id*. at *138.

[47] *Id*. at *139.

[48] *Id*. at *140.

[49] *Id.* at *140-41.

[50] *Id.* at *142.

[51] *Id.* at *142 n.184.

[52] *Id*. (citing Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004); and Strassburger v. Early, 752 A.2d 557 (Del. Ch. 2000)).

[53] 2004 Del. Ch. LEXIS 70, at *142 n.184.

[54] *Id.* at *146-47.

[55] *Id.* at *143.

[56] *Id.*

[57] *Id.* at *144.
[58] *Id.*
[59] *Id.* at *147.
[60] *Id.* at *148.
[61] *Id.*
[62] *See, e.g.,* In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 291 (Del. Ch. 2003) discussed *infra* at notes 121-133 and accompanying text.
[63] Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1995).
[64] *See, e.g.,* Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971, 973 (1994); Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 651 (2002); L.S. Sealy, *Fiduciary Relationships*, CAMBRIDGE L. J. 69, 70 (1962); Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333 (2002).
[65] LAWRENCE FRIEDMAN, HISTORY OF AMERICAN LAW (2d ed. 1985).
[66] *See* SHEPHERD, *supra* note 14, at 98.
[67] *See* Sealy, *supra* note 64, 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 64, at 334.
[68] *See* Horsey, *supra* note 64, at 974; Walsh, *supra* note 64, at 334.
[69] *See, e.g.,* Continuing Creditors' Comm. of Star Telecomms. Inc. v. Edgecomb 2004 US Dist LEXIS 25807 (Dist. of Del.) (Plaintiff must "plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence."); In re Gaylord Container Corp. Shareholders Litig. 753 A.2d 462, 476 (Del. Ch. 2000) (finds that a breach of loyalty may be committed either by self-interested actions or actions of bad faith); McMillan v. Intercargo Corp., 768 A.2d 492 (Del. Ch. 2000) (defendant's motion for judgment on the pleadings granted because plaintiffs failed to meet burden showing bad faith or self-dealing).
[70] *See* sources cited *supra* note 69 and accompanying text.
[71] Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests." (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939))); *see also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) ("[D]irectors must eschew any conflict between duty and self-interest."); Walsh, *supra* note 64, at 334. Most states have codified the duty of loyalty. *See* ALA. CODE § 10-2B-8.30 (2004); ALASKA STAT. § 10.06.450 (Michie 2004); ARIZ. REV. STAT. § 10-830 (2004); CAL. CORP. CODE § 309 (Deering 2004); CONN. GEN. STAT. § 33-756 (2003); FLA. STAT. ANN. § 607.0830 (West 2003); GA. CODE ANN. § 14-2-830 (2004); HAW. REV. STAT. ANN. § 414-221 (Michie 2003); IOWA CODE § 490.830 (2003); KY. REV. STAT. ANN. § 271B.8-300 (Michie 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 (2004); N.H. REV. STAT. ANN. § 293-A:8.30 (2004); N.M. STAT. ANN. § 53-4-18.1 (Michie 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); 15 PA. CONS. STAT. § 1712 (2004); R.I. GEN. LAWS § 7-1.1-33 (2004); S.C. CODE ANN. § 33-8-300 (Law. Co-op. 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).
[72] JOEL SELIGMAN, CORPORATIONS CASES AND MATERIALS 415 (1995).
[73] Guth v. Loft, 5 A.2d 503 (Del. 1939).
[74] *Id.* at 510.
[75] *Id*.
[76] Stegemeier v. Magness, 728 A.2d 557, 562 (Del. 1999) ("The absolute prohibition under common law against self-dealing by a trustee has been modified in the corporate setting to offer a safe harbor for the directors of a corporation if the transaction is approved by a majority of disinterested directors."); Schock v. Nash, 732 A.2d 217, 225 n.21 (Del. 1999) ("The statute … provides[s] corporate directors with a safe harbor from allegations of self-dealing if the transaction is approved by a majority of the informed and disinterested directors . . . ."); *see also* Oberly v. Kirby, 592 A.2d 445, 466-67 (Del. 1991) ("[S]ection 144 [of the Delaware Code] allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule.").
[77] *Stegemeier*, 728 A.2d at 562 ("If … the transaction is not approved by the requisite number of disinterested directors, the directors must prove that the transaction was entirely fair."); *see also Oberly*, 592 A.2d at 466-67 ("Where an independent committee is not available, the stockholders may either ratify the transaction or challenge its fairness in a judicial forum . . . . When a challenge to fairness is raised, the directors carry the burden of 'establishing . . . [the transaction's] entire fairness, sufficient to pass the test of careful scrutiny by the courts.'") (citations omitted); Cinerama, Inc. v.

Technicolor, Inc., 663 A.2d 1156, 1162 (Del. 1995) ("If the [business judgment] rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the "entire fairness" of the transaction to the shareholder plaintiff.").
[78] 663 A.2d 1156 (Del. 1995).
[79] *Id*. at 1140.
[80] *Id. See also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (1989) ("[B]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of litigation.").
[81] Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002).
[82] *Id.* at 22 (emphasis in original, footnotes omitted).
[83] *Id.* at 23 (quoting *Aronson v. Lewis*, 473 A.2d 804, 812 (Del. Supr. 1984)).
[84] *Id.* at 24 (citing *Rales v. Blasband*, 624 A.2d 927, 936 (Del. Supr. 1993)). *See also Orman* n.50 at 25 for a detailed discussion of the distinctions between "interested" and "lack of independence."
[85] *Orman*, 794 A.2d at 25.
[86] *Id.* at 26.
[87] *Id.* at 28.
[88] *Id.* at 28-29.
[89] *Id.* at 30.
[90] *Id.* at 29-30.
[91] *Id.* at 31.
[92] *Id*. at 31 n.70.
[93] Hollinger International, Inc. v. Hollinger Inc., No. 04 C 0698, 2005 WL 589000 (N.D. Ill. 2005).
[94] *Id.* at *27 (citing *Orman* at 22.).
[95] *Id.* at *2.
[96] *Id.* at *1.
[97] *Id.*
[98] *Id.* at *28 (citing *Orman v. Cullman*, 974 A.2d 5 (Del.Ch. 2002))(citations omitted).
[99] *Id.*
[100] Before bringing a derivative claim, the shareholder must first make a demand on the board of directors, unless demand would be futile. *See, e.g.*, Lewis v. Curtis, 671 F.2d 779, 787 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982). A board may refuse the shareholder's demand. A refusal of the board to pursue the claim demanded by shareholders is a decision of the board that will generally be afforded the usual protections of the business judgment rule provided it is made by disinterested directors in good faith. *See Aronson*, 473 A.2d at 813-17; Atkins v. Hibernia Corp., 182 F.3d 320, 324 (5th Cir. 1999); Cramer v. Gen. Tel. & Elec. Corp., 582 F.2d 259 (3d Cir. 1978). The presumptions of the business judgment rule in these circumstances thus operate as they would in any other situation. *Aronson*, 473 A.2d at 813-17.

There are situations where shareholders are not required to make a demand on the board because demand would be futile. These are often cases where it is the action of the board of directors that gave rise to the shareholder's claim. In cases where demand is excused, it is still possible for the board to terminate the litigation. Here, the courts look to whether the decision to terminate was made in good faith by disinterested directors, as well as apply their own business judgment to the decision at hand. Zapata Corp. v. Maldonado, 430 A.2d 779, 788-89 (Del. 1981) (if the corporation proves independence, good faith, and the reasonableness of its decision to terminate the suit, the court should apply its own business judgment to determine whether to grant the motion to dismiss).
[101] *Zapata*, 430 A.2d at 779.
[102] *Id.* at 788-89.
[103] In re Oracle Corp. Derivative Litig., 824 A.2d 917 (Del. Ch. 2003).
[104] *Id.* at 920 (citing Parfi Holding AB v. Mirror Image Internet, Inc., 794 A.2d 1211, 1232 (Del. Ch. 2001) (emphasis in original) *rev'd in part on other grounds*, 817 A.2d 149 (Del. 2002), *cert. denied*, 538 U.S. 1032 (2003)).
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] *Id.* at 920-21.
[109] *Id.* at 921.
[110] *Id.* at 928.
[111] *Id*. at 948.
[112] *Id.* at 942.
[113] In re eBay, Inc. S'holder Litig., No. 19988-NC, 2004 Del. Ch. LEXIS 4 (Del. Ch. Jan. 23, 2004).
[114] *Id.* at *11.

[115] *Id*. at *10-11.
[116] RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1992).
[117] *Id.* at § 170(2).
[118] 164 N.E. 545 (N.Y. 1928).
[119] *Id.* at 546.
[120] *Id*.
[121] In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 291 (Del. Ch. 2003).
[122] Brehm v. Eisner, 746 A.2d 244, 248 (Del. 2000).
[123] *Walt Disney Co.,* 825 A.2d. at 289.
[124] *Id*. at 287.
[125] *Id.* at 287-88.
[126] *Id*.
[127] *Walt Disney Co.*, 825 A.2d at 278.
[128] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
[129] *See, e.g.*, Sale, *supra* note 52, at 463 (arguing that Delaware case law "reveal[s] an emerging doctrine of good faith"). The cases include: Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001); McMullin v. Beran, 765 A.2d 910, 918 (Del. 2000); and Scattered Corp. v. Chi. Stock Exch., 701 A.2d 70 (Del. 1997).
[130] E. Norman Veasey, *State – Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors*, 28 IOWA J. CORP. L. 441, 447 (2003).
[131] DEL. CODE ANN. tit. 8 § 102(b)(7) (2004).
[132] Veasey, *supra* note 130, at 447.
[133] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).
[134] "The segment relying solely on defined contribution retirement plans, such as 401(k)s, rose from 40.8 percent to 61.5 percent in the 1992-2001 period…" *New EBRI Research: Defined Contribution Worker Coverage Grows; Retirement Savers Continue Reliance on Stocks,* U.S. NEWSWIRE, Jan. 21, 2004. Defined contribution plans now hold more than $3.9 trillion. *After Three Difficult Years, the Retirement-Plan Market Appears to be Regaining its Footing,* WALL ST. J., Apr. 26, 2004, at C3.
[135] Muir, *supra* note 7, at 111 n.19.
[136] 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, 8-9 (2002).
[137] See Dana M. Muir & Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?,* N.Y.U.J. LEGIS. & PUB. POL'Y (forthcoming 2005) (manuscript at 147-48, on file with authors) for a discussion of the authors' reasons for this terminology.
[138] Janice Kay Lawrence, *Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(k) Plan Participants*, 92 KY. L.J. 1, 4, n.8 (2003-2004). Employers have begun to reevaluate the use of company stock in these plans.
[139] Maureen B. Cavanaugh, *Tax as Gatekeeper: Why Company Stock is Not Worth the Money,* 23 VA. TAX. REV. 365, 378-79 (2003).
[140] Muir & Schipani, *supra* note 137, at Part V.B.
[141] The two primary categorizations of pension plans are as defined benefit or defined contribution plans. *See* Muir, *supra* note 136, at 5.
[142] JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY, 118 (2004).
[143] ERISA § 403, 29 U.S.C. § 1103 (2000).
[144] ERISA § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i) (2000); *cf*. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule,* 55 U. CHI. L. REV. 1105, 1108 (1988) ("ERISA's exclusive benefit rule... imports into pension fiduciary law one of the most fundamental and distinctive principles of trust law, the duty of loyalty."); EMPLOYEE BENEFITS LAW 662 (2d ed. 2000). In addition to the fiduciary obligation of loyalty ERISA requires fiduciaries to act prudently, to diversify investments, and to act in accordance with the benefit plan's terms to the extent those terms do not conflict with ERISA. ERISA § 404(a)(1)(B)-(D), 29 U.S.C. § 1104(a)(1)(B)-(D) (2000).
[145] ERISA § 408, 29 U.S.C. § 1108(c)(3) (2000). ERISA defines a party in interest to include plan service providers, an employer with employees who are plan participants, certain individuals and entities with an ownership interest in a plan sponsor, and plan fiduciaries. ERISA § 3(14), 29 U.S.C. § 1002(14) (2000).
[146] Fischel & Langbein, *supra* note 144, at 1126-28.
[147] ERISA § 406, 29 U.S.C. § 1106 (2000). The Department of Labor has issued numerous class and individual exemptions to the prohibited transactions provisions. For a detailed discussion of those exemptions, see DONALD J. MYERS & MICHAEL B. RICHMAN, CLASS EXEMPTIONS FROM PROHIBITED TRANSACTIONS, IN ERISA FIDUCIARY LAW 365 (Susan P. Serota ed., 1995); WILLIAM P. WADE & RICHARD I. LOEBL, INDIVIDUAL PROHIBITED TRANSACTION EXEMPTIONS, IN ERISA

FIDUCIARY LAW 365 (Susan P. Serota ed., 1995); EMPLOYEE BENEFITS LAW, *supra* note 144, at 744-62. One specific exception permits benefit plans to acquire employer securities for adequate consideration. ERISA § 408(e), 29 U.S.C. § 1108(e) (2000). Plaintiffs in the stock drop cases have unsuccessfully alleged that the use of company stock in the plan when the stock is an imprudent investment constitutes a breach of the prohibited transaction requirements because the stock is purchased for more than adequate consideration. In re: Honeywell International ERISA Litig., No 03-1214, 2004 U.S. Dist. LEXIS 21585, at *46-49 (D.N.J. Sept. 14, 2004).

[148] See ERISA § 408(b)(2), 29 U.S.C. § 1108(b)(2) (2000).

[149] ERISA § 403(c)(1), 29 U.S.C. § 1103(c)(1) (2000).

[150] Donovan v. Bierwirth, 680 F.2d 263, 271 (2nd Cir. 1982).

[151] Meinhard v. Salmon, 164 N.E. 545, 546 (Ct. App. N.Y. 1928); *see supra* text accompanying notes 1-2.

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

[153] Dana M. Muir, *ERISA Remedies: Chimera or Congressional Compromise?,* 81 IOWA L. REV. 1, 15 (1995).

[154] ERISA § 402(a), 29 U.S.C. § 1102(a) (2000).

[155] ERISA § 3(21)(A) 29 U.S.C. § 1002(21)(A) (2000).

[156] In re Elec. Data Sys. Corp. ERISA Litig., 305 F. Supp. 2d 658 (E.D. Tex. 2004); In re Enron Corp. Securities, Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 543 (S.D. Tex. 2003).

[157] *In re Electronic Data Systems Corp. ERISA Litig.*, 305 F. Supp. 2d at 666-67; *see also* In re Tyco Int'l Ltd. Multidistrict Litig., No. 02-1335-PB, 2004 U.S. Dist. LEXIS 24,272, at *16-17 (D.N.H. Dec. 2, 2004) (categorizing board members as fiduciaries due to power to appoint fiduciaries).

[158] LaLonde v. Textron, Inc., 369 F.3d 1 (1st Cir. 2004) (reversing dismissal); In re Xcel Energy, Inc., No. 02-2677, 2005 U.S. Dist. LEXIS 6432 (D. Minn. Apr. 8, 2005) (awarding attorneys fees); In re Xcel Energy, Inc., No. 02-2677, 2005 U.S. Dist. LEXIS 6436 (D. Minn. Apr. 1, 2005) (approving settlement); In re: Polaroid ERISA Litig., No. 03 Civ. 8335, 2005 U.S. Dist. LEXIS 5386 (S.D.N.Y. Mar. 31, 2005) (denying motion to dismiss); In re: AOL Time Warner, Inc. Securities and "ERISA" Litig., No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. March 10, 2005); In re Elec. Data Sys. Corp. ERISA Litig., No. 03-cv-126, 2005 U.S. Dist. LEXIS 3839 (E.D. Tex. Feb. 11, 2005) (certifying class); Penn. Fed'n v. Norfolk S. Corp., No. 02-9049, 2005 U.S. Dist. LEXIS 296 (E.D. Penn. Jan. 11, 2005) (certifying questions); In re CMS Energy ERISA Litig., No. 02-cv-72834, 2004 U.S. Dist. LEXIS 26862 (E.D. Mich. Dec. 27, 2004) (certifying class); In re Tyco Int'l Ltd. Multidistrict Litig., 2004 U.S. Dist. LEXIS 24,272, at *16-17 (denying motion to dismiss); Penn. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654 (E.D. Penn. Oct. 12, 2004) (dismissing exclusive purpose claim); In re Sprint Corp. ERISA Litig., No 03-2202-JWL, 2004 U.S. Dist. LEXIS 19125 (D. Kan. Sept. 24, 2004); In re AEP ERISA Litig., 327 F. Supp 2d 812 (S.D. Ohio 2004) (denying motion to dismiss); In re ADC Telecoms., No. 03-2989, 2004 U.S. Dist. LEXIS 14383 (D. Minn. July 26, 2004) (denying motion to dismiss); In re Lucent Technologies Sec. Litig., 327 F. Supp. 2d 426 (D.N.J. 2004) (awarding fees in settlement of securities and ERISA cases); In re Schering-Plough Corp. ERISA Litig., No. 03-1204, 2004 U.S. Dist. LEXIS 16265 (D.N.J. June 28, 2004) (granting motion to dismiss); Kling v. Fidelity Management Trust Co., 323 F. Supp. 2d 132 (D. Mass. 2004) (denying motion to dismiss); In re Sprint Corp. ERISA Litig., No 03-2202-JWL, 2004 U.S. Dist. LEXIS 9622 (D. Kan. May 27, 2004) (denying motion to dismiss); Rankin v. Rots, No. 02-cv-71045, 2004 U.S. Dist. LEXIS 6585 (E.D. Mich. Apr. 16, 2004) (certifying class); In re CMS Energy ERISA Litig., 312 F. Supp. 2d 898 (E.D. Mich. 2004) (denying motion to dismiss); Hill v. Bellsouth Corp., 313 F. Supp. 2d 1361 (N.D. Ga. 2004) (denying motion to dismiss); Cokenour v. Household Int'l, Inc., No. 02-c-7921, 2004 U.S. Dist. LEXIS 5286 (N.D. Ill. Mar. 30, 2004) (denying motion to dismiss); In re Xcel Energy ERISA Litig., 312 F. Supp. 2d 1165 (D. Minn. 2004) (denying motion to dismiss); In re Dynegy ERISA Litig., 309 F. Supp. 2d 861 (S.D. Tex. 2004) (denying motion to dismiss); In re Sears, Roebuck & Co. ERISA Litig., No. 02-c-8324, 2004 U.S. Dist. LEXIS 3241 (N.D. Ill. Mar. 3, 2004) (denying motion to dismiss); Penn. Fed'n v. Norfolk S Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 1987 (E.D. Penn. Feb. 4, 2004) (denying motion to dismiss); In re Elec. Data Sys. Corp. ERISA Litig., 305 F. Supp. 2d 658 (E.D. Tex. 2004) (denying motion to dismiss); In re Reliant Energy ERISA Litig., 2004 U.S. Dist LEXIS 1450 (S.D. Tex. 2004) (motion to dismiss denied); Crowley v. Corning, Inc., 02-cv-6172, 2004 U.S. Dist. LEXIS 758 (W.D.N.Y. Jan. 14, 2004) (denying motion to reconsider dismissal); In re Williams Companies ERISA Litig., No. 02-CV-153-H(M), 2003 U.S. Dist. LEXIS 25042 (N.D. Okla. Oct. 27, 2003) (denying motion to reconsider); Tittle v. Enron Corp., 284 F. Supp. 2d 511 (S.D. Tex. 2003) (denying motion to dismiss); Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003) (denying motion to dismiss); In re Williams Companies ERISA Litig., 271 F. Supp. 2d 1328 (N.D. Okla. 2003) (denying motion to dismiss); Stein v. Smith, 270 F. Supp. 2d 157 (D. Mass. 2003) (denying motion to dismiss); LaLonde v. Textron, Inc., 270 F. Supp. 2d 272 (D.R.I. 2003) (granting motion to dismiss); In re Duke Energy ERISA Litig., 281 F. Supp. 2d 786 (W.D.N.C. 2003) (granting motion to dismiss granted); In re WorldCom ERISA Litig., 263 F. Supp. 2d 745 (S.D.N.Y. 2003) (denying motion to dismiss denied); Kling v. Fidelity Mgmt. Trust Co., 270 F. Supp. 2d 121 (D. Mass. 2003) (denying motion to dismiss).

[159] Jessica Marquez, *Taking Stock*, WORKFORCE MGMT. 79-81 (May 2005), at http://www.workfoce.com/section/02/feature/24/03/71/index.html.
[160] 263 F. Supp. 2d 745, 763 (S.D.N.Y. 2003), *later opin.* No. 02 Civ.4816(DLC), 2004 LEXIS 20,671 (S.D.N.Y. Oct. 18, 2004) (approving partial settlement).
[161] No. 03 Civ. 8335, 2005 U.S. Dist. LEXIS 5386, *49 (S.D.N.Y. Mar. 31, 2005).
[162] 263 F. Supp.2d 745, 767 (S.D.N.Y. 2003).
[163] *Id.* at 768.
[164] *Id.*
[165] No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715, *9 (S.D.N.Y. March 10, 2005).
[166] *Id.* at *25.
[167] *Id.*
[168] No. 03-1214, 2004 U.S. Dist. LEXIS 21585, *44 (D.N.J. Sept. 14, 2004). It does not appear that these particular claims were alleged against company directors but the plaintiffs' theory would seem to apply to directors who receive stock-based compensation.
[169] *Id.* at *45.
[170] *Id.*
[171] *Id*. at *27-*34
[172] *Id.* at *35-40.
[173] *Id.* at *44-45.
[174] 313 F. Supp. 2d 1361, 1370 (N.D. Ga. 2004).
[175] *Id*.
[176] *Id.* at 1169-70.
[177] *Id.* at 1370.
[178] *See supra* text accompanying note 145.
[179] Mertens v. Hewitt Assocs., 508 U.S. 248, 251-52 (1993).
[180] 309 F. Supp. 2d 861, 896 (S.D. Tex. 2004).
[181] *Id.* at 897 (quoting Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 299 (5th Cir. 2000)).
[182] 309 F. Supp. 2d at 897-98.
[183] No. 02-9049, 2004 U.S. Dist. LEXIS 20654, *6 (E.D. Penn. Oct. 12, 2004), *later opin.*, 2005 U.S. Dist. LEXIS 296 (E.D. Penn. Jan. 11, 2005) (certifying questions).
[184] 2004 U.S. Dist. LEXIS 20654 at *6-7.
[185] 305 F. Supp. 2d 658, 673 (E.D. Tex. 2004).
[186] *Id.*
[187] *Id.*
[188] *Id.*
[189] *See* Muir & Schipani, *supra* note 137, at 144-47.
[190] *Id.* at 146-47.
[191] *Id.*
[192] 2004 U.S. Dist. LEXIS 21585
[193] Muir & Schipani, *supra* note 137, at 179-180.
[194] In re Enron Corp. Securities, Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 552 (S.D. Tex. 2003) ("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."); *see also* Questions and answers relating to fiduciary responsibility under the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.75-8, FR-17 ("At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan.").
[195] 337 F. Supp. 2d 1079 (N.D. Ill. 2004).
[196] *Id.* at 1096 (citation of record omitted). In *In re: AOL Time Warner, Inc. Securities and "ERISA" Litig.*, a similar claim, alleging that defendant board members breached their fiduciary duties by appointing company employees who lacked independence as fiduciaries, survived a motion to dismiss. No. 02 Civ. 8853, 2005 U.S. Dist LEXIS 3715, *24 (S.D.N.Y. Mar. 10, 2005).
[197] 337 F. Supp. 2d. at 1097.
[198] *Id.*
[199] *Id.*
[200] *Id.* (citation of record omitted).

[201] Plaintiffs in *In re WorldCom, Inc. ERISA Litigation*, argued that the company directors were fiduciaries because they acted on behalf of WorldCom who had been named by the plan as its Plan Administrator and Investment Fiduciary and thus the had fiduciary obligation to appoint and monitor plan fiduciaries. 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003), *later opin.* No. 02 Civ.4816(DLC), 2004 LEXIS 20,671 (S.D.N.Y. Oct. 18, 2004) (approving partial settlement).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. 263 F. Supp. 2d at 760. 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. *Id.* Nor, according to the court, does the argument appropriately recognize the difference between board members' obligations as plan settlors, which do not result in any fiduciary duty, and their obligations as plan fiduciaries. *Id.* at 761.
[202] 337 F. Supp. 2d at 1097-99.
[203] Edward E. Bintz, *Fiduciary Responsibility Under ERISA: Is There Ever a Fiduciary Duty to Disclose?,* 54 U. PITT. L. REV. 979, 980 (1993).
[204] Bryan L. Clobes, *In the Wake of Varity 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."). The Supreme Court, however, has left open the question of whether fiduciaries must make disclosures in the absence of a specific statutory or regulatory obligation and a direct question from a participant. In the context of potential transactions in plan stock, disclosure also raises securities law issues including insider trading. Muir & Schipani, *supra* note 137, at 162-63.
[205] Clobes, *supra* note 204, at 227.
[206] *See* Penn. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654, *8 (E.D. Penn. Oct. 12, 2004) (arguing the duty to disclose derives from the duty of prudence), *later opin.*, 2005 U.S. Dist. LEXIS 296 (E.D. Penn. Jan. 11, 2005) (certifying questions).
[207] 305 F. Supp 2d 658, 673 (E.D. Tex. 2004).
[208] *Id.*
[209] *Id.*
[210] Sarbanes-Oxley Act of 2002 (SOX), Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and other chapters (2002)).
[211] *See, e.g.*, Sale, *supra* note 52, at 456-62.
[212] *See supra* Part IV.C.
[213] In re Emerging Communs., Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, *142 n.184 (Del. Ch. May 3, 2004).
[214] *Id.* at *142. The court is not clear in this portion of the opinion about the extent of Raynor's economic interests and dependence on Prosser. Raynor, however, was both ECM's counsel and Prosser's personal attorney. The court also recognized that Raynor had acted in a number of different ways as a business associate of Prosser. Thus, Raynor's economic interests appear to have significantly exceeded his status as and payment for his role as an ECM director. *Id.* at *10.
[215] *Id.* at *142.
[216] *Id.* at *142, n.184.
[217] *Id.* at *142.
[218] *Id.* at *142 n.184.
[219] See *supra* text accompanying notes 10-11.
[220] No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. Mar. 10, 2005).
[221] 2005 U.S. Dist. LEXIS 3715, at *25.
[222] *Id*.
[223] *See supra* text accompanying notes 161-77.
[224] Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).
[225] In re Emerging Communs., Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, *38 (Del. Ch. May 3, 2004).

[226] *See id.*
[227] *Id.* at *101.
[228] *Id.* at *111-12.
[229] 62 F.3d 553 (3d Cir. 1995).
[230] *Id.* at 571 (quoting RESTATEMENT (SECOND) OF TRUSTS § 227 comment g. (1959)).
[231] In re: SYNCOR ERISA Litig., No. CV 03-2446, slip op. at 17 (C.D. Cal. Aug. 24, 2004); Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1098 (2002).
[232] *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).
[233] In re: Emerg. Commun., Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, *142 n.184 (Del. Ch. May 3, 2004).
[234] Muir & Schipani, *supra* note 137, at 179.
[235] *Id.* at 179-80.
[236] *Id.*