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Calling Off the *Lynch* Mob: The Corporate Director's Fiduciary Disclosure Duty

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I. INTRODUCTION

A. The Fiduciary Disclosure Duty Identified

Two parallel bodies of American law establish the obligations of corporate directors to disclose information about the corporation to its existing stockholders: (1) the Securities Exchange Act of 1934,[1]

1. 15 U.S.C. §§ 78a et seq. (1994 ed.). See generally Louis Loss and Joel Seligman, *Fundamentals of Securities Regulation* (Little, Brown, 3d ed. 1995); Thomas Lee Hazen, *The Law of Securities Regulation* (West, 3d ed. 1995). Directors are responsible under the Securities Exchange Act of 1934 for the fulfillment of the Act's disclosure obligations, at least insofar as they solicit proxies, *Gould v. American-Hawaiian Steamship Co.*, 351 F. Supp. 853, 856, 858 (D. Del. 1972), vacated on other grounds, 535 F.2d 761 (3d Cir. 1976); Edward Brodsky and M. Patricia Adamski, *Law of Corporate Directors and Officers* § 15:14 (1995 Supp.), or actively

and (2) state common law, including doctrines such as fraud and negligent misrepresentation.[2] Although these state common law doctrines have been applied to transactions in corporate securities, their significance has been largely eclipsed by comprehensive federal regulation.[3]

Of growing importance, however, is a state law duty that courts have created and imposed upon directors based upon their fiduciary relation to the corporation and its stockholders. In the last twenty years, this branch of fiduciary doctrine has blossomed prolifically, particularly in the Delaware state courts.[4] According to the Delaware Supreme Court in *Stroud v. Grace*,[5] it is now "well-recognized" that fiduciary duty requires directors to disclose all material

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supervise the preparation of periodic disclosures by the corporation. 15 U.S.C. § 78(t); *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1440-42 (9th Cir. 1987). Compare *Hemming v. Alfin Fragrances, Inc.*, 690 F. Supp. 239, 245 (S.D.N.Y. 1988) (holding that one's mere status as a director or officer is an insufficient basis for liability as a "controlling person" under section 20(a) of the Securities Exchange Act of 1934).

2. See, for example, *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 472 (Del. 1992) (discussing equitable fraud as a theory of liability for material omissions in a corporation's offer to purchase its own outstanding shares); *Alfus v. Pyramid Technology Corp.*, 745 F. Supp. 1511, 1523-24 (N.D. Cal. 1990) (evaluating stock purchasers' claim of negligent misrepresentation against the issuer's directors); *General Inv. Co. v. American Hide & Leather Co.*, 97 N.J. Eq. 230, 127 A. 659, 662 (N.J. Chanc. 1925) (invoking both fraud and trust concepts to impose upon directors a duty of disclosure in solicitation of proxies).

3. Indeed, it was the perceived inability of stato law to provide sufficient information to the securities markets that led to the enactment of comprehensive federal securities legislation. See, for example, Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* (Houghton Mifflin, 1982); Manuel F. Cohen, *Federal Legislation Affecting the Public Offering of Securities*, 28 Geo. Wash. L. Rev. 119, 125 (1959) ("Common law notions of culpable deceit and the mesh of 'Blue Sky' controls were not effective deterrents" to "[i]ncreasing recklessness in the flotation of securities . . . in the period prior to 1929."). This rationale, however, has been recently criticized. See Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure Of Corporate Law* 285-300 (Harvard U., 1991) (suggesting, as an alternative rationale for a national antifraud rule, the elimination of the necessity for multiple litigation forums for each fraudulent interstate stock issuance and criticizing customary rationales for mandatory disclosure requirements). In any event, dissatisfaction with state law also has been identified as the motivation for regulation of proxy solicitation under section 14(a) of the Securities Exchange Act of 1934:

> Notwithstanding the basic importance of the solicitation of proxies in determining the destiny of corporate management and affairs, and the temptations and abuses which almost inevitably accompany unrestricted power, the states did virtually nothing to cope with the problem. Prior to 1934, the managements of many corporations solicited proxies and perpetuated themselves in office without furnishing to the stockholders the most elementary facts concerning the corporation and the matters on which the stockholders were expected to vote. In many cases, the stockholders were not even informed of the names of the proposed directers or their connection with or stockholdings in the corporation.

Edward Ress Aranow and Herbert A. Einhorn, *Proxy Regulation: Suggested Improvements*, 28 Geo. Wash. L. Rev. 306, 306 (1959).

4. See Parts III and IV.

5. 606 A.2d 75 (Del. 1992).

information within their control when they seek stockholder action.[6] Just thirteen days after the *Stroud* opinion was issued, moreover, a Delaware trial court went further, holding that a fiduciary duty to disclose all material information arises when directors approve any public statement, such as a press release, regardless of whether any specific stockholder action is sought.[7]

As described in the Delaware cases, this fiduciary disclosure duty is deep, as well as broad. The duty is said to be strict, imposing liability without regard to director negligence or other culpability;[8] to afford stockholders a remedy without regard to whether they relied upon a statement made in violation of the duty;[9] and to afford a "virtual *per se* rule" of damages, under which stockholders may obtain a monetary award on account of a breach of the disclosure duty without having to establish actual loss.[10]

B. The Breadth of the Doctrine Illustrated

Consider where the foregoing articulation of the fiduciary disclosure duty would lead in the following hypothetical case: Directors of a Delaware corporation solicit proxies in support of a proposed merger in which the stockholders receive cash for their stock at a substantial premium over the prevailing market price. The merger is entirely at arm's length. There is no overlap of stock ownership between the acquiror and the target. Only a small minority of the target's board of directors are officers, and none of those officers receives either assurances of future employment, or any consulting contract or other special consideration in the merger. The sale process is impeccable, and the stockholders and the financial community universally accept the sale price as the highest reasonably available.

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6. Id. at 84.

7. *Marhart, Inc. v. Calmat Co.*, 18 Del. J. Corp. L. 330, 336 (Del. Chanc. 1992). See also *Ciro, Inc. v. Gold*, 816 F. Supp. 253, 266 (D. Del. 1993) ("It is also well-established Delaware law that once directors voluntarily undertake to make certain disclosures to the stockholders, they are obligated, under the so-called duty of complete candor, to disclose all material facts. This duty arises even when voluntary disclosure is made by the directors and no shareholder action in reliance thereon is requested or contemplated."); *Kahn v. Roberts*, 1994 WL 70118, *2 (Del. Chanc. Feb. 28, 1994) ("Even, as here, where stockholder approval was not sought or needed, directors who decide voluntarily to disclose information relating to a corporate transaction to stockholders are subject to the duty of full and frank disclosure of all material facts."), aff'd, 1996 WL 438724 (Del. July 25, 1996).

8. See notes 18-23 and accompanying text.

9. See note 24 and accompanying text.

10. See note 25 and accompanying text.

In short, there is no plausible claim of breach of any fiduciary duty to obtain the highest reasonably available price.[11]

With one possible exception, the process by which proxies are solicited from the stockholders is likewise impeccable. The directors take pains to assure that management, aided by experienced securities counsel, allows ample opportunity for review of the proxy statement. The directors themselves review late drafts of the proxy statement and supply helpful clarifications.[12] One disclosure point is reviewed in particular in a board meeting. After considerable discussion, counsel advises the directors that the proxy statement need not disclose year-old internal revenue and earnings projections for a division which has accounted for about twenty-five percent of sales and income. Having somehow learned of those projections, however, a former stockholder brings a class action against the former directors. The former stockholder seeks declaratory and injunctive relief, as well as rescission and damages, on the theory that the directors violated their fiduciary duty of disclosure by not including the projections in the proxy statement.

The directors move for summary judgment, and the court's analysis of applicable fiduciary duty principles begins with the observation that the directors were soliciting proxies when they presented the merger proposal to the stockholders for approval. Hence, under what has become black letter doctrine, the fiduciary duty of disclosure required the directors to disclose all facts within their control that were material to the merger proposal.[13] The court concludes that the projections could be material information, since a reasonable investor

11. See generally Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: The Impact of* QVC *and Its Progeny*, 32 Houston L. Rev. 945 (1995); Paul L. Regan, *The Unimportance of Being Earnest:* Paramount *Rewrites the Rules for Enhanced Scrutiny in Corporate Takeovers*, 46 Hastings L. J. 125 (1994); Lawrence A. Cunningham and Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor*: A Unified Standard (and the End of* Revlon *Duties?)*, 49 Bus. Law. 1593 (1994); Marcel Kahan, Paramount *or Paradox: The Delaware Supreme Court's Takeover Jurisprudence*, 19 J. Corp. L. 583 (1994); Stephen Fraidin and Jon D. Hanson, *Toward Unlocking Lockups*, 103 Yale L. J. 1739 (1994); Kenneth J. Nachbar, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*—The Requirement of a Level Playing Field in Contested Mergers, and Its Effect on Lock-Ups and Other Bidding Deterrents*, 12 Del. J. Corp. L. 473 (1987).

12. See Committee on Corporate Laws, Section of Business Law of the American Bar Association, *Corporate Director's Guidebook* 49-50 (2d ed. 1994) ("Directors should be particularly attentive to the procedures followed in preparing the corporation's proxy statements and should review them carefully before they are disseminated, to corroborate that there are no material misstatements or omissions.").

13. See, for example, *Stroud*, 606 A.2d at 85. Whether and te what extont this fiduciary disclosure duty exists in the absence of proxy solicitation, and why the solicitation of proxies should altor the substance of the fiduciary duty owed, are matters discussed in Part IV.C.1.

could have considered their disclosure a significant change in the "total mix" of available information.[14]

The defendant directors press their summary judgment motion, however, on three further points. First, the directors claim exoneration by reason of lack of evidence of negligence, let alone scienter, on their part. They point out that even under federal law, where congressional policy mandates full disclosure in the solicitation of proxies,[15] damages liability depends upon proof of negligence.[16] Therefore, they argue, there is no reason why any state common law policy of disclosure to stockholders[17] should be more exacting.

Second, the directors dispute that any stockholder actually relied on the nondisclosure of the projections, and have offered impressive proof that the merger vote would have been unaffected even if the projections had been disclosed. Finally, the directors maintain that no damages can be established. Specifically having failed to question the sufficiency of the process by which the company was sold, plaintiff cannot establish that the stockholders received anything less than full and fair value for their shares.

Adopting statements from the Delaware cases, however, the court rejects these three contentions summarily. Addressing first the plea of due care and good faith, the court cites a plethora of Delaware cases identifying a fiduciary duty to disclose material facts, and notes that none of those cases indicates that this duty can be breached only by a culpable failure to disclose.[18] The court also notes, quoting Chancellor William T. Allen in *In re Anderson, Clayton Shareholders'*

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14. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (adopting the materiality standard articulated by the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

15. See, for example, *TSC Industries*, 426 U.S. at 444; *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381 (1970); *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964).

16. Damages liability in a private action under SEC Rule 14a-9 for material omissions in a proxy statement is generally understood to require a showing of culpability at least amounting to negligence. *Shidler v. All American Life & Financial Corp.*, 775 F.2d 917, 927 (8th Cir. 1985); *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 777-78 (3d Cir. 1976); Brodsky and Adamski, *Law of Corporate Directors* § 15:18 (cited in note 1).

17. See *Stroud*, 606 A.2d at 86-87 (stating that Delaware law adopts the same disclosure standard as federal law).

18. See, for example, *Arnold v. Society for Savings Bancorp, Inc.*, 678 A.2d 533 (Del. Chanc. 1996); *Williams v. Geier*, 671 A.2d 1368, 1379 (Del. 1996); *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59, 66 (Del. 1995); *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270, 1277 (Del. 1994); *Zirn v. VLI Corp.*, 621 A.2d 773, 778 (Del. 1993); *Stroud*, 606 A.2d at 84; *Shell Petroleum, Inc. v. Smith*, 606 A.2d 112, 114-15 (Del. 1992); *Smith v. Van Gorkom*, 488 A.2d 858, 890 (Del. 1985); *Barkan v. Amsted Industries, Inc.*, 567 A.2d 1279, 1288 (Del. 1989); *Lewis v. Leaseway Transportation Corp.*, 1990 Fed. Secur. L. Rptr. (CCH) ¶ 95,275 at 96,268 (Del. Chanc. May 16, 1990); *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651, 659 n.2 (Del. Chanc. 1988); *Glassman v. Wometco Cable TV, Inc.*, 11 Del. J. Corp. L. 649, 656 (Del. Chanc. 1985).

Litigation,[19] that "the question whether shareholders have, under the circumstances, been provided with appropriate information upon which an informed choice on a matter of fundamental corporate importance may be made, is not a decision concerning the management of business and affairs of the enterprise"[20] and therefore is not a matter on which the due care and good faith of the directors can, as under the business judgment rule applicable to management decisions, carry the day for the defendants.[21] Citing scholarly comment,[22] the court disavows any culpability requirement by observing that a transaction should not be allowed to go forward where stockholder approval is being obtained on the basis of materially incorrect or incomplete information simply because the directors reasonably, but incorrectly, believed in the sufficiency of the information.[23]

The directors' second and third defenses fall more easily. The court rebuffs their attempt to disprove reliance, reciting the Delaware

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19. 519 A.2d 669 (Del. Chanc. 1986).

20. Id. at 675.

21. Id. See also *Estate of Detwiler v. Offenbacher*, 728 F. Supp. 103, 150 n.18 (S.D.N.Y. 1989) (noting that the business judgment rule is inapplicable to allegations of misrepresentations or omissions in a proxy statement); *Kahn v. Lynch Communication Systems, Inc.*, 669 A.2d 79, 88 (Del. 1995) (holding that materiality is "determined from the perspective of the reasonable shareholder, not that of the directors or other party who undertakes to distribute information"); *Zirn*, 621 A.2d at 779-80 (holding that the materiality of an omission should be determined by applying a broad objective standard); *Lewis*, 1990 Fed. Secur. L. Rptr. ¶ 95,275 at 96,268 (holding that the business judgment rule has no applicability to the question of whether shareholders have been provided with appropriate information to make an informed choice); *In re Tri-Star Pictures, Inc. Litigation*, 1990 Fed. Secur. L. Rptr. (CCH) ¶ 95,319, at 96,526, 96,531 (Del. Chanc. June 14, 1990) (holding that the business judgment rule does not apply to disclosure issues).

22. Commentators have remarked upon the absence of any recitation of a culpability element of a breach of the fiduciary duty of disclosure. See, for example, J. Robert Brown, Jr., *The Regulation of Corporate Disclosure* § 9.03[4] at 9-20 (2d ed. 1995 Supp.) ("Delaware cases have not explicitly imposed a state of mind requirement for violations of the duty of candor."); Donald E. Pease, *Delaware's Disclosure Rule: The "Complete Candor" Standard, Its Application, and Why Sue in Delaware*, 14 Del. J. Corp. L. 445, 486-87 (1989) (noting that "under the Delaware cases . . . the plaintiff need not prove that the flawed disclosure was caused by either scienter or negligence" and concluding that "Delaware has a strict liability standard in the disclosure area . . ."). Brown treads with caution on the point, however, noting the "possibility . . . that the courts will specifically confront the issues and impose a state of mind requirement." Brown, *Corporate Disclosure* § 9.02 at 9-21 (cited in this note).

23. *Anderson Clayton*, 519 A.2d at 675. Chancellor Allen observed that there has been no case in which:

> [A] truly important piece of information, within the knowledge of the board, had not been disclosed, but the court nevertheless denied an application for a preliminary injunction on the basis that while the Court found the information highly material, reasonable men could differ on the subject and the board's decision not to disclose, having been made in good faith, should be deferred to. I doubt that that is the law.

Id.

See also *Zirn*, 621 A.2d at 779 ("[A] material omission is not rendered immaterial simply because the party making the omission honestly believes it insignificant.").

Supreme Court's terse rejection of the argument: "Delaware law is settled that there is no reliance requirement in a claim for breach of a fiduciary duty of disclosure."[24] With equal dispatch, the court passes over the absence of proof of actual damages, quoting a Delaware Supreme Court ruling that "[i]n Delaware existing law and policy have evolved into a virtual *per se* rule of damages for breach of the fiduciary duty of disclosure."[25]

In short, by a plausible, and arguably mandatory, reading of Delaware case law, a court may be obliged to require directors to pay damages on account of a failure to disclose what is determined in hindsight to have been a material fact in connection with a transaction in which the directors had no self-interest and acted with the utmost good faith and due care. Further, no stockholder could establish either reliance on the nondisclosure or damage resulting from the merger accomplished by means of the deficient proxy statement.

One may be skeptical that a court would follow the language of the Delaware cases to this logical end, since monetary liability even for the negligent action of disinterested directors is rare and disfavored by the law.[26] As logically as the result would seem to follow from the case law, holding the disinterested directors personally liable in damages for a nondisclosure, regarding which they reasonably relied on advice of counsel, would seem difficult to reconcile with statutes which purport to protect reasonable director reliance upon the advice of experts such as securities counsel.[27]

Nevertheless, since the broad articulation of fiduciary disclosure duty in the recent Delaware cases *potentially* implies director liability in the hypothetical case described above—liability that is inconsistent with customary notions of the limits of such liability—it is worthwhile to reassess the evolution of the case law in order to supply a more logical and predictable framework for future cases. Such a reassessment of the doctrinal foundations of the fiduciary duty of disclosure, moreover, clarifies a potentially critical uncertainty under present case law. So long as the courts characterize the director's fiduciary disclosure duty as an ill-defined hybrid of the duties of

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24. *In re Tri-Star Pictures, Inc.*, 634 A.2d 319, 327 n.10 (Del. 1993) (citing *Van Gorkom*, 488 A.2d at 858; *Weinberger v. UOP, Inc.*, 457 A.2d 701, 701 (Del. 1983)).

25. *Tri-Star Pictures*, 634 A.2d at 333.

26. See notes 267-69 and accompanying text.

27. See 8 Del. Code Ann. § 141(e) (1994). See also Model Bus. Corp. Act Ann. § 8.30(b) (Prentice Hall, 3d ed. 1996 Supp.).

care and loyalty,[28] directors and corporate counsel will be uncertain as to whether exculpatory provisions in the certificate of incorporation can effectively limit or eliminate damages liability for breach of that fiduciary disclosure duty.[29]

C. How Did We Get Here, and Where Do We Go From Here?

The evolution of judicial treatment of the director's fiduciary disclosure duty has received little systematic attention. Scholarly comment directly addressing this emerging state law concept is not extensive.[30] In two brushes with the matter, the American Law Institute first avoided altogether an attempt to define the concept,[31] and later dealt with the concept only as a facet of the duty of loyalty.[32] Much of the sparse scholarly commentary is devoted to cataloguing how the courts have assessed the materiality of various kinds of information.[33] To the limited extent that these commentators have

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28. A recent opinion of the Delaware Supreme Court notes, without analysis, that the "duty of disclosure" is "an obligation that has been characterized as a derivative of the duties of care and loyalty." *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1166 (Del. 1995).

29. Although the Delaware statute permits elimination, by charter provision, of monetary liability of directors for breach of fiduciary duty, it does not allow elimination of liability for breach of the duty of loyalty. 8 Del. Code Ann. § 102(b)(7). In a 1993 opinion, the Delaware Supreme Court found such an exculpatory provision insufficient to preclude monetary liability for breach of the fiduciary duty of disclosure. *Zirn*, 621 A.2d at 783 (discussed at Part IV.C.2.). But see *Arnold*, 650 A.2d at 1287 (holding that the statute expressly protects directors from liability for breach of the fiduciary disclosure requirements) (discussed at Part IV.C.3).

30. See generally R. Franklin Balotti and Jesse A. Finkelstein, 1 *The Delaware Law of Corporations and Business Organizations* § 22.10 (Aspen Law & Business, 2d ed. 1996 Supp.); Dennis J. Block, Nancy E. Barton, and Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* 197-215 (Prentice Hall, 4th ed. 1993 and 1995 Supp.); Brown, *Corporate Disclosure* § 9.02 at 39 (cited in note 22); Lewis D. Solomon, *Corporations Law and Policy, Materials and Problems* 890-96 (3d ed. 1994); David A. Drexler, *Delaware Corporation Law and Practice* ¶ 15.07A (1996 Supp.); Ernest L. Folk III, Rodman Ward Jr., and Edward P. Welch, *Folk on the Delaware General Corporation Law* § 212.4.2 (Little, Brown, 3d ed. 1992 and 1996 Supp.); Dale A. Oestorle and Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 Iowa L. Rov. 485, 565-70 (1994); Pease, 14 Del. J. Corp. L. at 445 (cited in note 22); Steven J. Rothschild and Keith R. Sattesahn, *"All Germane Facts With Complete Candor"—Delaware's Disclosure Duty*, in *Delaware Law for Corporate Lawyers—Recent Developments* 323-52 (Practicing Law Institut, 1985).

31. See Restatement (Second) of Torts § 551 cmt. e (1977) ("It is not within the scope of this Restatement to state the rules that determine the duty of disclosure which under the law of business associations the directors of a company owe to its shareholders.").

32. *Principles of Corporate Governance: Analysis and Recommendations* §§ 5.02, 5.04 (ALI 1994) (*"ALI Principles"*) (defining director disclosure obligations in situations involving self-dealing and use of material inside information in transactions in the corporation's stock).

33. See, for example, Balotti and Finkelstein, *Delaware Law of Corporations* §§ 22.10(C), 22.11 (cited in note 30); Block, *Business Judgment Rule* at 199-208 (cited in note 30); Brown, *Corporate Disclosure* §§ 9.03[3], [5] (cited in note 22); Folk, Ward, and Welch, *Delaware General Corporation Law* §§ 212:30-:39 (cited in note 30); Pease, 14 Del. J. Corp. L. at 458-476 (cited in

attempted to identify the source of the directors' fiduciary disclosure duty, they have tended to describe it as the courts have: in a unitary fashion, in which the character of the duty—to whom it is owed, when it is owed, and the remedies for its breach—is the same in whatever context it arises.[34] Tracking the broad language of recent Delaware case law, they have characterized this fiduciary duty, in generalized terms, as a "duty of candor,"[35] or, more recently, as a fiduciary "duty of disclosure."[36]

This approach, however, suffers from the same defect that has characterized the courts' development of the law: an unsurprising but often uncritical tendency to follow elevated moral rhetoric, which the courts use to describe the director's fiduciary duties, into contexts in which such rhetoric was never intended to apply.[37] Thus, in the years

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note 22); Rothschild and Sattesahn, *Delaware's Disclosure Duty* in *Delaware Law for Corporate Lawyers* at 335-352 (cited in note 30).

34. The tendency to view fiduciary disclosure duty in this unitary fashion finds considerahle support in the case law. Recent treatment of the duty by the Delaware Supreme Court identifies a "duty of disclosure" as a distinct legal obligation which is "derivative of the duties of care and loyalty," but apparently distinct and separate from those duties. *Cinerama*, 663 A.2d at 1166; *Zirn*, 621 A.2d at 778. Moreover, suggestions that the duty should vary according to the character of the transaction have met with judicial criticism. See, for example, *Barkan*, 567 A.2d at 1288 (rejecting a test that would define materiality more stringently in cases of director self-interest). But see *Cottle v. Standard Brands Paint*, 1990 Fed. Secur. L. Rptr. (CCH) ¶ 95,306 (Del. Chanc. Mar. 22, 1990) (holding that directors' opinions as to adequacy of self-tender offer are immaterial, particularly since the transaction does not eliminate steckholders' equity interests).

35. Pease, 14 Del. J. Corp. L. at 447 (cited in note 22) ("Delaware's disclosure standard . . . [is] known as the rule of 'complete candor.' "); Brown, *Corporate Disclosure* § 9.01 at 9-3 n.2 (cited in note 22) (stating that although "court terminology has not been so clear," "the duty of candor will encompass any affirmative obligation on the part of a company that arises out of fiduciary obligations to shareholders"); Oesterle and Palmiter, 79 Iowa L. Rov. at 565 (cited in note 30) (discussing the common law duty of "complete candor").

36. *Stroud*, 606 A.2d at 84. The court noted that "the term 'duty of candor' has no well accepted meaning in the disclosure context. Its use is both confusing and imprecise given the well-established principles and duties of disclosure that otherwise exist. Thus, it is more appropriate for our courts to speak of a duty of disclosure based on a materiality standard rather than the unhelpful terminology that has crept into Delaware court decisions as a 'duty of candor.' " Picking up the hint, Solomon describes a "state law duty of disclosure" owed by corporate fiduciaries. *Corporations Law* at 890 (cited in note 30).

Whether the substitution of the phrase "duty of disclosure" for "duty of complete candor" has done more for doctrinal clarity than new clothes did for the emperor is unclear. To the extent that *Stroud* urges adherence to "well-established principles and duties of disclosure that otherwise exist" in corporate law, however, it is entirely consistent with the thrust of this article. *Stroud*, 606 A.2d at 84.

37. The fervent tone and moral quality of discourse on fiduciary duties have been frequently remarked upon and explained as devices to strengthen the efficacy of rules of fiduciary behavior where detection of misbehavior and enforcement through litigation are likely to be erratic.

> By obscuring the limits of fiduciary obligations under moralistic rhetoric and by verbally chastising those who are found to have violated the standard, or come close to doing so, the courts seek to maintain the standard by discouraging marginal behavior which

after a leading Delaware Supreme Court opinion, *Lynch v. Vickers Energy Corp.*,[38] described a fiduciary duty of "complete candor," of "complete frankness ... [under which c]ompletenesss, not adequacy, is both the norm and the mandate,"[39] the courts naturally latched onto that language to identify a fiduciary disclosure duty in a variety of contexts strikingly different from the self-dealing context addressed in *Lynch*.[40]

This Article argues that this progression in the recent Delaware cases represents an overreaction by the corporate bench and bar to the force of the fiduciary rhetoric in *Lynch* and its progeny.[41] Hence the title of this article, suggestive of the psychological phenomenon in which a group, stirred by collective moral fervor and indignation, attempts, without due deliberation, to mete out sanctions in circumstances in which such sanctions are truly not deserved or appropriate.[42]

A measured approach to determining the appropriate scope and character of the director's fiduciary duty of disclosure first requires a recognition that fiduciary relations are too diverse and complex to permit identification of a singular, uniform disclosure duty having the same content in all contexts. To sharpen the definition of the fiduciary duty of disclosure, this Article proceeds in three steps. The first step is to examine two legal sources to which the fiduciary disclosure duty has sometimes been traced: a repealed Delaware

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> might or might not violate it. It is the imprecision of the standard and the fact that there are limitations on its scope which cannot be acknowledged in the judicial formulations that lead the courts to employ excessive rhetorical force in promulgating fiduciary doctrine. Ambiguity breeds vehemence. Further, the knowledge that fiduciary principles cannot be precisely and minutely enforced leads to the use of strong language as a control mechanism.

J. A. C. Hetherington, *Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities*, 22 Wake Forest L. Rev. 9, 11 (1987). See also Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in John W. Pratt and Richard J. Zeckbauser, eds., *Principals and Agents: The Structure of Business* 55, 75-76 (Harvard Bus. School, 1991) (noting that in enforcing fiduciary duties, judges "try to create feelings of guilt for violation of duty and rectitude for fulfillment of duty, and even conjure up an aura faintly resembling that which churches try to put around the duties of ministers to their congregations or of parents to their children").

38. 383 A.2d 278 (Del. 1977).

39. Id. at 281.

40. See Part IV.

41. See id.

42. See Harper Lee, *To Kill A Mockingbird* (Lippincott, 1960); Walter Van Tilburg Clark, *The Ox-Bow Incident* (Readers Club, 1942). The analogy between the evolution from *Lynch* and the evolution of a lynch mob is obviously imperfect, and it would be foolish to infer that the fiduciary disclosure duty issue has so inflamed the passion of the Delaware courts as to blind them to reason. It would be equally foolish, however, not to acknowledge that rhetoric, on the subject of fiduciary duty or otherwise, may obscure or drive out reasoned analysis.

statute prescribing director and officer liability for false statements concerning the corporation;[43] and older case law identifying a state law obligation to disclose material facts in the solicitation of proxies.[44] Admittedly this first step fails to advance the analysis. The Article concludes that neither of the legal areas examined is appropriately identified as a source of the director's fiduciary duty of disclosure.

The second, and more productive, step is to examine the judicial opinions which directly articulate and apply concepts of fiduciary duty to require disclosure by corporate directors. This examination reveals the extent to which the courts have recently extended the fiduciary disclosure duty beyond the contexts in which such a duty had traditionally been identified. Before *Lynch*, the fiduciary disclosure duty of directors had been limited to situations in which the directors' personal financial interest conflicted with that of the corporation and the stockholders generally. Thus, a fiduciary duty of disclosure was identified in cases where a director relied upon stockholder ratification of a self-dealing transaction,[45] or, as in *Lynch* itself, where the fiduciary's knowledge of favorable but confidential corporate information permitted the fiduciary to acquire stock from a minority or outside stockholder at an unfairly low price.[46] In *Smith v. Van Gorkom*, however, the Delaware Supreme Court established that failure to disclose material information to stockholders could expose a director to liability for breach of fiduciary duty even in the entirely distinct context in which the director is disinterested.[47]

This Article concludes that much of the judicial development of the fiduciary duty of disclosure can be placed on a theoretical and precedential footing that reinforces the legitimacy of that law. That firm footing can ultimately be found, however, only by taking a third analytical step; that is, by identifying the principles that define generally when a fiduciary relationship arises, ascertaining the disclosure duties such relationships engender, and determining the remedies appropriate for breach of each disclosure duty.[48]

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43. See Part II.A (discussing 21 Del. Laws 273, § 21 (1899) (repealed in 1967)).
44. See Part II.B.
45. See Part III.A.
46. See Part III.B.
47. 488 A.2d at 872-73. That development and the significant Delaware cases following it are explored in Part IV.
48. See Part V.

D. Fundamental Fiduciary Principles: A Preview

Because it highlights the very distinct contexts in which fiduciary duties may arise, the exercise of identifying basic principles of fiduciary duty helps delineate the directors' fiduciary duty of disclosure. For example, one form of fiduciary disclosure duty is a corollary of the traditional fiduciary duty of loyalty. That traditional fiduciary principle applies where a person who is empowered to manage the property of others for their benefit uses such property for personal benefit.[49] In modern corporation law, such self-dealing behavior, while not flatly forbidden, is subject to the most searching degree of judicial scrutiny.[50] The remedies for breach of the duty of loyalty may extend not only to compensating the beneficiary for out-of-pocket loss occasioned by the breach, but also to disgorgement by the fiduciary of profits gained from the breach.[51]

Where the self-dealing fiduciary, in order to avoid strict judicial scrutiny and expansive remedies for breach of the duty of loyalty, seeks the consent of the persons whose interests the fiduciary is charged to protect, the law invariably insists that such consent be fully informed.[52] That insistence reflects and buttresses the severity of the rules limiting fiduciary self-dealing generally. If the law did not insist that the fiduciary affirmatively demonstrate that the beneficiary's consent was fully informed, the force of restraints against self-dealing conduct could be readily avoided.[53] Therefore, the fiduciary has an affirmative duty to disclose all facts material to the benefi-

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49. Austin Wakeman Scott and William Franklin Fratcher, 2A *The Law of Trusts* § 170 at 311 (Little, Brown, 4th ed. 1987); J.C. Shepherd, *The Law of Fiduciaries* 35 (1981). See also Part V.A.

50. See, for example, *Weinberger*, 457 A.2d at 710 (noting that in a self-dealing transaction, the defendant has the burden of establishing the "entire fairness" of the transaction); *Oberly v. Kirby*, 592 A.2d 445, 467 (Del. 1991) (stating that an interested transaction can be upheld if approved by a neutral decision-making body); *Guth v. Loft, Inc.*, 5 A.2d 503, 512 (Del. 1939) ("It was incumbent upon [the directer] te show that his every act in dealing with the opportunity presented was in the exercise of the utmost good faith to the corporation.").

51. Shepherd, *Law of Fiduciaries* at 37-38 (cited in note 49); *Lynch v. Vickers Energy Corp.*, 429 A.2d 497, 503-04 (Del. 1981).

52. See, for example, *Wolf v. Frank*, 477 F.2d 467, 477 (5th Cir. 1973) (refusing te find that the uninformed vote of the shareholders of a corporation constituted ratification); *Wendt v. Fischer*, 234 N.Y. 439, 154 N.E. 303, 304 (1926) (holding that for disclosure to be effective, it must "lay bare the truth, without ambiguity or reservation, in all its stark significance"); Restatement (Second) Of Trusts § 216(2) (1957) ("The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if... the beneficiary, when he gave his consent, did not know of... the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew....."). See also Part III.A.

53. See note 265.

ciary's decision whether to consent to the self-dealing conduct of the fiduciary.[54] And indeed, much of the precedent applying a director fiduciary duty of disclosure has arisen in precisely the context in which the director relies upon stockholder consent to defend a transaction in which the director has a conflicting personal interest.[55]

To posit and define a fiduciary duty of disclosure in the absence of conflicting personal interest, however, requires resort to fiduciary principles very different from those that characterize the duty of loyalty. That distinct set of fiduciary principles—essentially a facet of the duty of care—is evoked where directors recommend how stockholders should vote or otherwise act on matters affecting their stock.[56] In making such recommendations, directors ordinarily have far greater knowledge, or access to knowledge, than do non-managing stockholders.[57] Thus, directors who recommend that stockholders vote a certain way, or sell (or not sell) their shares in response to a tender offer, place themselves in a position in which stockholders necessarily and properly rely upon that superior knowledge in determining how to act on a matter directly affecting their own interests as stockholders.

In such circumstances, the law has placed some duty, often characterized as fiduciary, upon the informationally advantaged advising party to disclose material facts to the informationally disadvantaged party who reasonably and foreseeably relies upon the advice given.[58] In the absence of self-interest, the directors' function of managing the disclosure of information to stockholders is similar to the directors' function of prudent management of the affairs of the corporation generally. Both involve effort by the directors to manage corporate resources to serve the best interests of the stockholders.[59] Therefore, the directors' duty of disclosure in recommending stockholder action should mirror the directors' duty of care, requiring no more (and no less) than the exercise of due care by the directors in gathering and presenting to the stockholders the information material to the decision the stockholders are being called upon to make. Since directors are not strictly liable as insurers for the outcome of their disinterested business decisions,[60] disinterested directors should

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54. Scott and Fratcher, 2A *Law of Trusts* § 170 at 312 (cited in note 49).

55. See Part III.A.

56. One example is when the directors recommend that stockholders approve a merger agreement. See Part V.C.

57. See note 260.

58. See note 333.

59. See note 336.

60. See notes 266-69, 338 and accompanying text.

likewise not be strictly liable as insurers of the completeness of the information they present to stockholders when they recommend stockholder action.

Where director self-interest is absent, there is no need for strict liability or disgorgement-type remedies to discourage fiduciary opportunism. Fiduciary attention to prudent management has been thought adequately encouraged by a regime in which director liability requires proof of negligence or "gross negligence,"[61] and remedies are limited to compensating victims of fiduciary inattention for their resulting out-of-pocket loss.[62] More expansive liability and remedies have been thought unduly to discourage individuals from serving as directors.[63] Monetary remedies for breach of the director's duty to disclose material facts in connection with recommendations of stockholder action, then, as with breach of the duty of care and the analytically similar tort of negligent misrepresentation,[64] should be limited to loss sustained by the stockholders as a result of the breach.

E. Applying Fundamental Fiduciary Principles to the Director's Duty of Disclosure: A Preview and Summary

As more fully developed in the material that follows, the reasons for imposing a fiduciary duty of disclosure upon corporate directors justify application of such duty in a manner considerably less dramatic than some commentators have intimated.[65] Subject to laying a more detailed foundation below, the following paragraphs propose a restatement of the fiduciary duty of disclosure:

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61. *Van Gorkom*, 488 A.2d at 873. See also note 267 and accompanying text; William M. Fletcher, 3A *Fletcher Cyclopedia of the Law of Private Corporations* § 1037 at 44-45 (Callaghan, perm. ed. 1994) (arguing that excessive director liability increases agency costs).

62. *Cinerama*, 663 A.2d at 1148-49, aff'd, 663 A.2d 1156 (Del. 1995); *ALI Principles* § 7.18(a) (cited in note 32).

63. R. Franklin Balotti and James J. Hanks, Jr., *Rejudging the Business Judgment Rule*, 48 Bus. Law. 1337, 1342 (1993); Fletcher, 3A *Cyclopedia of the Law of Private Corporations* § 1037 at 42 (cited in note 61).

64. See text accompanying notes 348-50.

65. For example, in his treatment of the "duty of candor"—probably the most thorough and thoughtful to date—Brown states that "[t]he doctrine does have the potential to revitalize state law in the proxy area . . . . Under the duty of candor, a company may arguably have an affirmative obligation to disclose material developments as they occur." Brown, *Corporate Disclosure* § 9.02 at 9-28 (cited in note 22). Solomon speculates that "[i]t may be that the duty to disclose applies to *all* communications by fiduciaries to shareholders, regardless of whether shareholder action is required." *Corporations Law* at 892 (cited in note 30). See also Oesterle and Palmiter, 79 Iowa L. Rev. at 566 (cited in note 30) ("Shareholders use the 'complete candor' tool principally to challenge (and effectively rewrite) the terms of mergers, reorganizations, and charter amendments—a substitute for fiduciary review on the merits.").

1. In the case of a transaction in which directors have a material personal interest in conflict with the interests of the corporation or its stockholders generally, those directors owe a fiduciary duty, when seeking approval of the transaction by the vote of disinterested stockholders, to disclose all facts that are material to the stockholders' consideration of the transaction and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure, whether culpable or not, will eliminate any validating effect that a favorable stockholder vote otherwise might have on the transaction. Unless the stockholder vote is a prerequisite to accomplishment of the transaction, however, that failure will not of itself constitute an independent wrong for which a remedy must be afforded.

2. Where directors buy stock directly from, or sell stock directly to, an existing outside stockholder—that is, a stockholder who is not a director, officer or controlling stockholder—those directors owe a fiduciary duty to the stockholder to disclose all facts that are material to the stockholder's consideration of the purchase or sale and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure will subject the transaction to injunctive relief or rescission in appropriate circumstances, and will subject the directors to monetary liability measured by the out-of-pocket damages sustained by the outside stockholder, or, in appropriate circumstances, by the amount of profit realized by the director as a result of the transaction.

3. Where directors submit for stockholder approval, or communicate to the stockholders a recommendation with regard to, a transaction or matter in which they have no material personal interest in conflict with the interests of the corporation or its stockholders generally, but as to which stockholders may reasonably expect to rely on the recommendation of directors as to what action to take with regard to their shares—as, for instance, where directors make a recommendation in a Schedule 14D-9[66] whether stockholders should tender their shares in response to a tender offer by a third party—the directors owe a fiduciary duty to exercise reasonable care to disclose all facts that are material to the stockholders' consideration of the transaction or matter and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure may warrant an injunction against, or rescission of, the transaction, but will not be the basis for an award of damages against

66. See SEC Rules 14d-9 and 14e-2, 17 C.F.R. §§ 240.14d-9 and 240.14e-2 (1996).

the directors in the absence of (i) negligence or bad faith, (ii) reliance by the stockholders seeking to recover damages on account of that failure, and (iii) proof of damages proximately caused by that failure.

4. Where directors make a statement to the public generally which does not on its face solicit or recommend action by the stockholders, the directors have no fiduciary duty of disclosure, although they may be liable to stockholders under common law fraud principles for actual damages if their statement is false or misleading due to a knowing misstatement or omission of a material fact, and the stockholders rely on such misstatement or omission and sustain injury as a result.

II. SEARCHING FOR THE SOURCE OF THE FIDUCIARY DUTY OF DISCLOSURE: TWO FALSE STARTS

A. *The Statutory Myth*

Several commentators have suggested that, at least under Delaware law, the source of the directors' fiduciary disclosure duty to stockholders is a statute which was adopted in 1899 and repealed in 1967 as part of the general revision of the Delaware General Corporation Law ("former section 144").[67] Closer analysis, however, demonstrates that this suggestion is erroneous. The statute did not create or codify a fiduciary duty to stockholders. Instead, it merely codified a rule of common law fraud establishing liability to creditors and investors that was not rooted in, and did not depend upon, a preexisting fiduciary relationship.[68]

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67. 21 Del. Laws 273, § 21 (1899), later codified at 8 Del. Code Ann. § 144 (1953) (referred to herein as "former section 144"). See Solomon, *Corporations Law* at 890 (cited in note 30) ("The Delaware duty of disclosure can be traced ultimately te a now repealed state statute: 8 Del. C. § 144 (1953)."); Brown, *Corporate Disclosure* § 9.02 at 9-4, 9-28 (cited in note 22) (describing the "duty of candor" as "historically grounded in a state statute," and describing that statute's disclosure requirement as a "relatively sleepy edifice until the 1970s"); Drexler, *Delaware Corporation Law* ¶ 15.07A at 15-36 (cited in note 30) (noting that prior to *Lynch*, "the duty of a corporation's management to provide information to steckholders had been measured by a fraud standard . . . [which f]rom 1899 until it was repealed in 1967 . . . had been embodied in the statute itself"); Pease, 14 Del. J. Corp. L. at 448 (cited in note 22) ("Even before any Delaware case stated requirements on disclosure, the General Corporation Law of Delaware (GCL) required accurate information in certain communications to shareholders.").

68. The statute in question provided:

> If the directors or officers of any corporation organized under the provisions of this chapter, shall knowingly cause to be published or give out any written statement or report of the condition or business of the corporation that is false in any material respect, the officers and directors causing such report or statement to be published, or given out,

From this statute—curiously, even long after its repeal—the Delaware Court of Chancery in *Marhart, Inc. v. Calmat Co.* inferred a continuing, common law duty on the part of corporate directors "to honestly disclose all material facts when they undertake to give out statements" concerning the condition or business of their corporation.[69] Having described this disclosure duty as one owed to stockholders, the court on reargument clarified that the duty is *not* owed to nonstockholders, not even persons who become stockholders in reliance on flawed disclosures by corporate directors.[70]

Delaware's 1899 statute, however, is devoid of any language indicating that existing stockholders were the exclusive beneficiaries of the disclosure obligation that the statute either created or codified. To the contrary, the history of former section 144 shows that it operated as an antifraud statute of general commercial application by codifying the proposition that corporate creditors and purchasers of the corporation's securities could claim damages for fraudulent written statements made by the directors regardless of any lack of privity or pre-existing fiduciary relationship with those directors.

The predecessor of former section 144, and similar state statutes then existing, demonstrate the creditor and securities purchaser protection purposes of former section 144. Before 1899, the Delaware statute (first enacted in 1883) prescribed a monetary remedy that was quite clearly limited to those who extended credit to the corporation.[71]

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or assenting thereto, shall be jointly and severally, individually liable for any loss or damage therefrom.

21 Del. Laws 273, § 21 (1899).

69. *Marhart*, 18 Del. J. Corp. L. at 336 (citing *Kelly v. Bell*, 254 A.2d 62, 71 (Del. Chanc. 1969), for the proposition that "[t]he legal rule announced in § 144 seems to have survived the repeal of the statute" in 1967). For that "rule" to have survived the repeal of the statute, however, it must necessarily have been part of the common law. Ordinarily, "[u]nder common law principles all rights, liabilities, penalties, forfeitures and offenses which are of purely statutory derivation and unknown to the common law are eliminated by the repeal of the statute which granted them, irrespective of the time of their accrual." Norman J. Singer, 1A *Sutherland Statutory Construction* § 23.33 (5th ed. 1993). Yet neither *Marhart* nor *Kelly* cites any authority indicating that directors owed a general fiduciary duty to stockholders under common law to disclose all material facts when giving out written statements concerning the business or condition of the corporation.

70. *Marhart, Inc. v. Calmat Co.*, 18 Del. J. Corp. L. 740, 743 (Del. Chanc. 1992) ("There is nothing in this Court's earlier decision concerning disclosures to nonstockholders and, as defendants note in their motion for reargument, fiduciary duties run to stockholders, not prospective stockholders.") (citing *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171 (Del. 1988)).

71. The statute provided:

If any certificate made, or any public notice given by the officers of any company in pursuance of the provisions of this act shall be false in any material representation, all the officers who shall have signed the same shall be jointly and severally liable for all the debts of the corporation contracted while they were stockholders or officers thereof.

Since liability for fraudulent written statements under statutes like the 1883 Delaware statute was limited to corporate debts, rather than consequential damages generally, cases interpreting similar statutes readily recognized the creditor protection purpose of the statutes.[72]

The 1899 revision of the Delaware statute, however, expanded its scope. Like statutes previously adopted in California[73] and in Illinois,[74] it extended liability for fraudulent written statements beyond corporate debts to include damages sustained by any person, not just corporate creditors, resulting from the fraudulent statements.[75] Under this revised statute, persons who purchased or sold the corporation's securities in reliance on knowingly incorrect representations published by the directors or officers about the condition or business of the corporation could assert fraud claims against those directors and officers, even though they did not deal directly with those directors or officers.[76] Although the revised 1899 Delaware statute may

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17 Del. Laws, 147 § 31 (1883). For similar and contemporaneous state statutes, see, for example, *Steam Engine Co. v. Hubbard*, 101 U.S. 188 (1879) (applying Connecticut's statute); Prescott F. Hall, *The Law of Massachusetts Business Corporations* 302 (3d ed. 1917) (discussing Massachusetts's statute); James B. Dill, *The Statutory and Case Law Applicable to Private Companies Under the General Corporation Act of New Jersey and Corporation Precedents* 78 (3d ed. 1901) (discussing New Jersey's statute); Frank Hubbard Twyeffort, *Business Corporations in New York* § 352 at 397-98 (1918) (quoting New York's statute prescribing liability to persons who become stockholders in reliance on false reports)).

72. *Steam Engine Co.*, 101 U.S. at 194 (applying Conn. Rev. Stat. § 404 and stating that "[s]tatutes of the kind are passed for the benefit of creditors, and their reliance always is upon the officers who are such when they give the credit . . . ."); *Felker v. Standard Yarn Co.*, 148 Mass. 226, 19 N.E. 220, 221 (1889) ("[N]o doubt one important reason, perhaps the principal reason, for the statutory provisions, is to enable persons who may have occasion to deal with corporations to ascertain their condition, and their title to credit . . . .").

73. The statute provided:

> Any officer of a corporation who willfully gives a certificate, or wilfully makes an official report, public notice, or entry in any of the records or books of the corporation, concerning the corporation or its business, which is false in any material representation, shall be liable for all the damages resulting therefrom to any person injured thereby; and if two or more officers unite or participate in the commission of any of the acts herein designated, they shall be jointly and severally liable.

Cal. Civ. Code § 316 (West, 1874) (in effect July 1, 1874).

74. The statute provided:

> If any certified report or statement made, or public notice given by the officers of any corporation, shall be false in any material representation, all the officers who shall have signed the same, knowing it to be false, shall be jointly and severally liable for all damages resulting therefrom.

Ill. Rev. Stat. ch. xxxii, § 21 (1872).

75. 21 Del. Laws 273, § 21 (1899).

76. Although there appear to be no reported Delaware cases under former section 144 involving claims of liability by allegedly defrauded stock purchasers or sellers, a similar statute has provided the basis for such claims. See *Smeland v. Renwick*, 50 Cal. App. 565, 196 P. 283, 285 (1920) (involving a claim against directors by allegedly defrauded purchasers of corporate bonds and common and preferred stock and invoking Cal. Civ. Code § 316).

have been superfluous in light of existing case law,[77] legislative intent to afford a remedy to defrauded stock purchasers seems apparent.[78] The statute's purpose of protecting investors generally, rather than just existing stockholders, is also quite plausible since it predated by thirty-four years the enactment of comprehensive federal regulation of disclosure in stock issuances.[79]

After the enactment of federal securities laws governing fraudulent issues of stock, however, state corporation statutes became increasingly irrelevant to the protection of creditors.[80] Statutes like former section 144 generally atrophied or disappeared altogether as a result of disuse.[81] The vestigial successor to such statutes, section

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77. Case law in jurisdictions outside of Delaware held that defrauded purchasers of corporate stock could sue directors and officers directly to recover damages resulting from fraudulent written representations about the corporation disseminated by the directors or officers to the public.

> [I]t has often been decided that directors are liable for fraudulent representations as to the financial condition of the company, whereby others are induced to give credit to the company, or to purchase its obligations or shares of its stock. . . . It is not necessary that the misrepresentation be made by the directors directly to the party complaining.

Victor Morawetz, 1 *A Treatise on the Law of Private Corporations* § 573 (Little, Brown, 2d ed. 1886).

> It is hardly necessary to say that a director of a company who knowingly issues or sanctions the circulation of a false prospectus, containing untrue statements of material facts, the natural tendency of which is to mislead and deceive the community, and to induce the public to purchase its stock, is responsible to those who are injured thereby.

Id. § 543 (citing, among other cases, *Morgan v. Skiddy*, 62 N.Y. 319, 326 (1875) (Andrews, J.)).

78. Indeed, a text written a few years after the 1899 revision annotates the revised Delaware statute with references to case law imposing liability upon stock promoters for material misrepresentations to, or concealment of material facts from, potential subscribers. J. Ernest Smith, *The Law of Business Corporations Organized Under the General Corporation Law of the State of Delaware* 83-84 (2d ed. 1904).

79. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1994 ed.).

80. See, for example, Bayless Manning and James J. Hanks, Jr., *Legal Capital* 91 (Foundation Press, 3d ed. 1990) ("It is a safe generalization . . . that the statutory legal capital machinery provides little or no significant protection to creditors of corporations."); 1 Model Bus. Corp. Act Ann. at 6-218 (noting that the 1980 elimination of capital concepts from the Model Business Corporation Act was "based on the premise that the complex structure of rules established by earlier versions of the Model Act did not provide realistic protection to creditors or senior securities holders").

81. Thus, as the court notod in *Marhart*, there is not even any legislative history surrounding the elimination of former section 144 in the 1967 revision of the Delaware General Corporation Law. *Marhart*, 18 Del. J. Corp. L. at 335. The extensive volume prepared by the reporter for the revision committee is silent on the failure to carry forward the provisions of former section 144. See generally Ernest L. Folk III, *Review of the Delaware Corporation Law* (1968).

Only two states retain statutes that make directors or officers liable in damages to persons who rely to their injury upon knowingly false statements in puhlished corporate documents. Ariz. Rev. Stat. § 10-1631 (West, 1995) (prescribing liability "to a person who has become a crediter or shareholder of the corporation on the faith of the false material representation . . . for all damages resulting"); Ohio Rev. Code Ann. § 1701.93 (Page, 1994). Interestingly, the Ohio statute has in recent years served as the basis for imposing personal liability upon corporato officers. See *In re Walsh*, 143 B.R. 691, 695-96 (N.D. Ohio 1992)

1.29 of the Model Business Corporation Act, prescribes only criminal misdemeanor liability, rather than civil damages liability.[82] Even that criminal liability is limited to false statements in filings with the secretary of state or the equivalent office, and does not extend to statements in corporate disclosures in general.[83]

Former section 144 disappeared when the Delaware General Corporation Law was revised in 1967.[84] Cited in only one reported case while it was still in force,[85] former section 144 has been dusted off in *Marhart* and in scholarly comment to sustain and define a doctrine of fiduciary duty that the statute was never intended to encompass during its life, let alone after its death by repeal. The true source of the fiduciary duty of disclosure of corporate directors must therefore be found elsewhere.

B. Distinguishing Common Law Proxy Disclosure Obligations From a Fiduciary Duty of Disclosure

At least one observer has suggested that a fiduciary duty of directors and officers to disclose material facts to stockholders can be traced to cases which apply common law principles to evaluate claims

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(refusing to declare a default judgment non-dischargeable under Ohio Rev. Code Ann. § 1701.93); *Hinkle v. Sherwood Products, Inc.*, 13 Ohio App. 3d 414, 469 N.E.2d 869, 870-72 (Ohio Ct. App. 1983) (holding officer liable to employee for medical costs, due to entry on pay stubs and time cards falsely showing medical insurance coverage).

82. Model Bus. Corp. Act Ann. § 1.29.

83. Id.

84. See note 81.

85. *Hall v. John S. Isaacs & Sons Farms, Inc.*, 146 A.2d 602, 609-10 (Del. Chanc. 1958). *Hall* refers to former section 144, and states the general principle that directors must honestly disclose all material facts when they undertake to disclose corporate information, but finds no proof of "false or fraudulent annual reports," and rejects such as a basis for appointment of a receiver. Id. at 610. Thus, *Hall* is incorrectly cited as a case under former section 144 "impos[ing] liability for false disclosure." Brown, *Corporate Disclosure* § 9.02 at 9-4 (cited in note 22). To the contrary, *Hall's* reference to former section 144 and a duty of disclosure on the part of corporate directors is dictum.

Likewise, the case relied on in *Marhart* to establish that the disclosure duty described in *Hall* persisted after repeal of former section 144—*Kelly v. Bell*—even less persuasive in supporting the existence of a fiduciary duty of disclosure to stockholders. True, *Kelly* does state, citing *Hall*, that "directors owe a duty to honestly disclose all material facts when they undertake to give out statements about the business to stockholders." *Kelly*, 254 A.2d at 71. The claim before the court, however, was that the directors should be liable in a derivative suit for payments made to local governments. The legal issue was whether the protection of the business judgment rule should be denied because the directors' description of those payments as "taxes" "constituted fraud or gross abuse of discretion." Id. The statement in *Kelly* on which the court in *Marhart* relied is, like the comparable statement in *Hall*, pure dictum.

of false or misleading solicitation of proxies.[86] There is some truth to this perception, inasmuch as directors and officers have long been held to have obligations of disclosure, sometimes characterized as "fiduciary" in nature, when they solicit proxies.[87] Certainly, state law challenges to proxy solicitation disclosures were quite common,[88] at least until 1964 when federal regulation of proxy solicitation was extended beyond stock exchange listed issuers.[89]

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86. See Pease, 14 Del. J. Corp. L. at 448 (cited in note 22) ("As early as 1946, the court of chancery discussed disclosure requirements in *Empire Southern Gas Co. v. Gray*, [46 A.2d 741 (1946)].").

87. *Willoughby v. Port*, 182 F. Supp. 496, 499 (S.D.N.Y. 1960), modified on other grounds, 277 F.2d 149 (2d Cir. 1960) (enjoining dissident stockholders from exercising proxies, and holding that "[t]hose who seek the proxies of their fellow corporate shareholders assume a fiduciary obligation"); *Dal-Tran Service Co. v. Fifth Ave. Coach Lines, Inc.*, 220 N.Y.S.2d 549, 554 (N.Y. App. Div. 1961) (following *Willoughby* but sustaining uncontested election of management nominees); *Skora v. Great Sweet Grass Oils, Ltd.*, 205 N.Y.S.2d 98, 104-06 (N.Y. Sup. Ct. 1960) (finding that while proxies solicited by dissident stockholders of an Ontario corporation were "invalid under the law of Ontario" because they "were obtained by reason of fraudulent representations or fraudulent omissions of material facts .... Even if the publicity here was defective only in that it did not tell the whole truth, the failure to make such a full disclosure would have been a breach of fiduciary obligation").

88. In addition to the cases cited in note 87, see *Bresnick v. Home Title Guaranty Co.*, 175 F. Supp. 723 (S.D.N.Y. 1959); *Empire Southern Gas Co. v. Gray*, 46 A.2d 741 (Del. Chanc. 1946); *Goldfield Corp. v. General Host Corp.*, 327 N.Y.S.2d 330, 277 N.E.2d 387 (N.Y. 1971); *Mason v. Basic Properties, Inc.*, 230 N.Y.S.2d 560 (N.Y. Sup. Ct. 1962), aff'd, 232 N.Y.S.2d 391, 17 A.D.2d 769 (N.Y. App. Div. 1962); *In re R. Hoe & Co.*, 137 N.Y.S.2d 142 (N.Y. Sup. Ct. 1954), aff'd, 139 N.Y.S.2d 883 (Sup. Ct. App. Div. 1955), aff'd, 309 N.Y. 719, 128 N.E.2d 420 (1955); *Wyatt v. Armstrong*, 59 N.Y.S.2d 502 (N.Y. Sup. Ct. 1945); *In re Scheuer*, 59 N.Y.S. 2d 500 (N.Y. Sup. Ct. 1942); *Continental Bank & Trust Co. of New York v. 200 Madison Avenue Corp.*, 43 N.Y.S.2d 402 (N.Y. Sup. Ct. 1943); *Western Oil Fields, Inc. v. McKnab*, 232 F. Supp. 162 (D. Colo. 1964). See also Comment, *Standards of Disclosure in Proxy Solicitation of Unlisted Securities*, 1960 Duke L. J. 623, 637 (apparently chafing at the then inapplicability of federal proxy rules to unlisted companies, urging that "[t]he state courts should insure protection to the stockholder through the establishment of minimum standards of disclosure or, in the alternative, consider the proxy rules of the Securities and Exchange Commission when passing upon the adequacy of disclosure in solicitation"); Edward Ross Aranow and Herbert A. Einhorn, *State Court Review of Corporate Elections*, 56 Colum. L. Rev. 155, 160-61, 176 (1956) (discussing state cases involving challenges to proxy solicitation); John E. Theuman, Annotation, *Misrepresentation in Proxy Solicitation—State Cases*, 20 A.L.R.4th 1287 (1983) (listing cases).

89. Securities Acts Amendments of 1964, Pub. L. No. 88-467, §§ 3(c), 5(a), 78 Stat. 565, 566-67, 569 (1964). Since 1964, cases invoking only state common law disclosure duty on the part of proxy solicitors have become a rarity. A rare exception—a case involving a Native American development corporation exempted by federal statute from the reach of the securities laws—indicates that such state law cases have been displaced by litigation under section 14(a) of the Exchange Act, and Rule 14a-9 promulgated pursuant to that statute. *Brown v. Ward*, 593 P.2d 247 (Alaska 1979). Indeed, the *Brown* case, even while nominally applying state law, simply followed standards under the federal securities laws as "a useful guide in determining when a misstatement is material under Alaska common law." Id. at 250. The dissent in that case, however, cogently disagreed:

> Certainly there is no reason, in law or policy, why Alaska must march in lockstep with the federal government on this subject .... [Courts applying common law proxy solicitation disclosure duties] have taken a compromise position between the federal standard and the common law tort of misrepresentation.

Nevertheless, these older proxy solicitation cases should not be viewed as the source of a fiduciary disclosure duty of directors. As these cases make clear, the duty to avoid fraud in the solicitation of proxies, and not any duty arising from a preexisting fiduciary relationship, forms the basis for scrutiny of proxy solicitation disclosures under common law.[90] Thus, the disclosure duties articulated in the

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Id. at 255 (O'Connor, J. dissenting). See also *Washington State Labor Council v. Federated American Ins. Co.*, 474 P.2d 98, 101 (Wash. 1970) (holding that a state statute governing solicitation of proxies of stock of insurers and requiring disclosure of "the material matters in regard to which the powers so solicited are proposed to be used," did not require advance disclosure by management of its strategy for cumulating votes at the meeting).

90. Although the cases sometimes characterize the proxy solicitor's disclosure duty as arising from a fiduciary relationship with the solicitees, see note 87 and accompanying text, the cases more commonly invoke principles of common law fraud, a doctrine applicable without regard to any preexisting fiduciary relationship, and therefore applicable not only to traditional corporate fiduciaries but to dissident proxy solicitors as well. See, for example, *Bresnick*, 175 F. Supp. at 725 ("The test is not compliance with the technical rules, but rather whether the proxy soliciting material was so tainted with fraud that an inequitable result was accomplished."); *Empire Southern Gas Co.*, 46 A.2d at 743 ("[B]oth precedent and practice support the right of this court to interfere prior to a stockholders' meeting to prevent fraud in the solicitation of proxies."); *Continental Bank*, 43 N.Y.S.2d at 405 ("[T]he proof failed to establish any fraud in the securing [by dissident voting trust certificate holders] of proxies, either by way of untruthful statements of material facts or the suppression of material facts such as would amount to fraud.... [T]his court should limit its consideration solely to the question of whether there was fraud in soliciting the proxies."); *Western Oil Fields*, 232 F. Supp. at 164 ("Apparently a stronger showing of fraud must be made when an injunction is sought under state law than when it is sought for a violation of SEC Proxy Rule X-14A-9 forbidding false or misleading statements.") (citing Edward Ross Aranow and Herbert A. Einhorn, *Proxy Contests For Corporate Control* 435 (Columbia U., 1957)).

The fraud basis of the state proxy solicitation cases is consistent with the insistence in some of those cases that a stockholder vote will be set aside only if the challenger can demonstrate actual reliance by stockholders upon the allegedly defective disclosure, or that the result of the vote would have been different but for the defective disclosure. *Goldfield*, 277 N.E.2d at 392 ("The test... is whether... there is a substantial likelihood that the misstatement... may have led a stockholder to grant a proxy to the solicitor or to withhold [it]... whereas in the absence of this he would have taken a contrary course.") (quoting *General Time Corp. v. Talley Industries*, 403 F.2d 159, 162 (2d Cir. 1968)); *Bresnick*, 175 F. Supp. at 725 (holding that facts allegedly omitted from the management proxy statement were "fully disclosed in letters sent to stockholders by the committee opposing the plan and there is no indication in the papers that the stockholders were misled by omission te put these particular figures in the Management proxy soliciting material"); *Continental Bank*, 43 N.Y.S.2d at 408 ("None of the statements of facts which are alleged te be untrue would, in the opinion of the court, influence any layman to give a proxy where he would not otherwise have done so."); *R. Hoe & Co.*, 137 N.Y.S.2d at 148 ("Even assuming there were misstatements or concealments, the election may not be set aside unless the court concludes further that the result would have been different had no such improprieties been injected inte the proxy campaign, or that an inequitable result has been thereby produced."); *Mason*, 230 N.Y.S.2d at 563 ("I do not find that the alleged misstatements and concealments in the Proxy Statement were such as te mislead a substantial number of stockholders as to alter the probable result of the vote on the adoption of the plan."). Compare *Scheuer*, 59 N.Y.S.2d at 501 ("[I]t is not necessary to show that stockholders were actually deceived. It is sufficient to show that they might have been.") (citing *American Hide*, 127 A. at 661). The more relaxed reliance and causation tests recited without analysis in *Scheuer* are probably attributable to the context of the *American Hide* case on which *Scheuer* relied. The challenge to the stockholder vote in *American Hide* arose not in a contested election, but state law proxy solicitation cases unquestionably apply not only to incumbent directors and officers but to dissident or insurgent proxy solicitors as well.[91]

At least with the benefit of hindsight, moreover, it seems inappropriate to characterize as "fiduciary" the common law disclosure duty of proxy solicitors, both management and dissident. The cases that used that terminology did not explain why a fiduciary relationship should be deemed to govern the actions by which a proxy is obtained, as distinguished from the use and execution of proxy authority once it is conferred.[92] Indeed, the relationship of solicitee to solicitor does not, in and of itself, involve any of the vulnerability and expectation of reliance that ordinarily justify application of a fiduciary obligation.[93]

Perhaps reflecting that view, most observers have suggested that the older state law proxy solicitation cases are not a viable source of the more recently articulated director's "duty of candor," or the

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because defendants had invoked stockholder ratification in defense of a self-dealing contract between a director and the corporation—a context in which fiduciary disclosure duties have traditionally been applied. *American Hide*, 127 A. at 660. See Part III.A.

91. *Western Oil Fields*, 232 F. Supp. at 166; *Willoughby*, 182 F. Supp. at 499; *Empire Southern Gas Co.*, 46 A.2d at 746; *Skora*, 205 N.Y.S.2d at 104; *R. Hoe & Co.*, 137 N.Y.S.2d at 147-48; *Wyatt*, 59 N.Y.S.2d at 506; *Continental Bank & Trust*, 43 N.Y.S.2d at 406-07.

92. See *Hauth v. Giant Portland Cement Co.*, 96 A.2d 233, 235 (Del. Chanc. 1953) ("The person designated in a proxy has a fiduciary obligation to carry out the wishes of the stockholders to the best of his ability."); *Abbey Properties Co. v. Presidential Insurance Co.*, 119 So.2d 74, 78 (Fla. Dist. Ct. App. 1960) (holding that the proxy relationship is one of agent and principal); Fletcher, 5 *Cyclopedia of the Law of Private Corporations* § 2060 at 291 (cited in noto 61) ("The person to whom the proxy runs is the shareholder's agent, and must vote in accordance with the instructions given him or her, either openly or tacitly, by the latter, and as a fiduciary.").

State v. Jefferson Lake Sulphur Co., 36 N.J. 577, 178 A.2d 329 (1962), illustratos the wide scope of the courts' willingness te employ fiduciary doctrine to sustain a disclosure obligation. The court held that management, as custodian of unclaimed dividend funds attributable to lost stockholders, had a fiduciary duty to disclose all material facts when seeking the approval of stockholders (presumably those stockholders who were *not* lost) for a charter amendment cutting off rights to dividends unclaimed for a defined time period, in order to avoid escheat. Id. at 332-34. The court stated:

> Even assuming that the charter change under review was not *ultra vires*, in a situation where a corporation seeks to influence its steckholders to 'escheat' their property to it rather than have it pass to the State, the fiduciary status which the corporation occupies with respect to the unclaimed dividends calls for full and fair disclosure of all the relevant facts upon which the stockholders' decision should be formulated. Obviously the obligation was not adequately discharged by the proxy statement and that reason alone is sufficient warrant for invalidating the amendment.

Id. at 333. As discussed in Part V.C below, the rationale for this decision could have been better articulated as a duty to disclose all material facts to stockholders to whom a recommendation is being made, rather than as a duty to an unclaimed pot of cash, or to those who have claims to that cash but who were not even aware of, let alone voting upon, the proposed charter provision.

93. See Part V.C.

fiduciary disclosure obligation of directors and officers.[94] This Article therefore turns in the following sections to cases in which the courts have articulated a duty of disclosure explicitly attributed to the fiduciary status of the director.

III. THE TRADITIONAL CONTEXTS OF THE FIDUCIARY DUTY OF DISCLOSURE

A. Ratification Disclosure Duty

The first and oldest instance in which the courts have invoked fiduciary duties as a basis for a director disclosure duty is the unwavering requirement of disclosure of material facts where corporate fiduciaries solicit and rely upon stockholder consent to a transaction between the fiduciary and the corporation.[95] In *Cahall v. Lofland*,[96] the Delaware Chancellor stated the requirement concisely: "The burden is on him who relies on a ratification to show that it was made with a full knowledge of all material facts."[97]

The reasons why corporate managers seek stockholder ratification are varied. In some cases, stockholder ratification is intended to supply retroactive corporate authority for action taken by directors or others whose authority to take the action has been questioned.[98] In others, corporate fiduciaries seek ratification in order to secure favorable judicial treatment of transactions alleged to involve self-dealing or waste that might otherwise be reviewed under a more stringent

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94. Brown thus notes that the *Empire Southern Gas Co. v. Gray* case, in which proxies were challenged because certain officers misleadingly claimed endorsement by the Board, was not "a true duty of candor case." Brown, *Corporate Disclosure* § 9.02 at 9-4 n.8 (cited in note 22). Similarly, Solomon discusses the state law cases governing proxy solicitation entirely separately from the analysis of the "Delaware duty of disclosure." Solomon, *Corporations Law* at 841-43, 890-96 (cited in note 30).

95. See, for example, *Wolf*, 477 F.2d at 477; *Gaynor v. Buckley*, 318 F.2d 432, 435 (9th Cir. 1963); *Ramacciotti v. Joe Simpkins, Inc.*, 427 S.W.2d 425, 432 (Mo. 1968); *Barclay v. Dublin Lake Club*, 89 N.H. 500, 1 A.2d 633, 636 (1938); *Iback v. Elevator Supplies Co., Inc.*, 177 A. 458, 459 (N.J. Chanc. 1935). See also Fletcher, 2A *Cyclopedia of the Law of Corporations* § 764 at 549 (perm. ed. 1992) (cited in note 61) ("Shareholders must have knowledge before they will be deemed to have barred their rights by ratification.").

96. 114 A. 224 (Del. Chanc. 1921), aff'd, 118 A. 1 (Del. 1922).

97. Id. at 234.

98. *Michelson v. Duncan*, 407 A.2d 211, 219-20 (Del. 1979); *Hannigan v. Italo Petroleum Corp.*, 47 A.2d 169, 172 (Del. 1945); *Peters v. Waverly Water-Front Improvement & Development Co.*, 113 Va. 318, 74 S.E. 168, 170 (1912). See also Henry Winthrop Ballantine, *Ballantine on Corporations* § 60 at 151-52 (Callaghan, rev. ed. 1946).

standard, such as "entire fairness."[99] Even in cases in which stockholder approval is a statutory prerequisite to accomplishing the challenged transaction, and thus where the term "ratification" may be inapt,[100] corporate fiduciaries invoke the stockholder vote in a similarly defensive way, to reduce the intensity of judicial scrutiny, or avoid such scrutiny altogether.[101] In all of these contexts, however, the effectiveness of the ratification defense depends upon proof that the stockholders were fully informed about what they were approving when they approved it. If such proof is not forthcoming, the challenged transaction is examined without the curative or burden-shifting effect of stockholder approval.[102]

Many of the Delaware cases which describe a fiduciary duty of disclosure or of complete candor do so merely in an effort to determine whether stockholder approval may be invoked defensively. In fact, the Delaware courts first used the term "complete candor" in such a case, nearly twenty years before *Lynch* elevated the term to common

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99. *Gottlieb v. Heyden Chemical Corp.*, 91 A.2d 57, 58-59 (Del. 1952); *Fidanque v. American Maracaibo Co.*, 92 A.2d 311, 321 (Del. Chanc. 1952). The entire fairness doctrine is a device by which the courts impose upon self-dealing corporate directors the burden of establishing that their transactions with the corporation are fair both substantively, that is, as to price, and procedurally. See, for example., *Weinberger*, 457 A.2d at 710-11; Block, Barton, and Radin, *Business Judgment Rule* at 131-32 (cited in note 30); Lawrence A. Mitchell, *Fairness and Trust in Corporate Law*, 43 Duke L. J. 425, 443-45 (1993); *ALI Principles* § 5.02(b) (cited in note 32). The Delaware Supreme Court has said that the entire fairness test requires "careful scrutiny" by the courts, *Weinberger*, 457 A.2d at 710, and that determining whether to apply that test "frequently is determinative of the outcome" of litigation challenging a self-dealing transaction. *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993) (citing *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988)). In recent years, however, the Delaware Supreme Court has upheld several transactions despite applying that ostensibly demanding test. *Kahn*, 669 A.2d at 79; *Cinerama*, 663 A.2d at 1156; *Nixon*, 626 A.2d at 1366.

100. Stockholder ratification, in traditional form, has been described as "the voluntary addition of an independent layer of shareholder approval in circumstances where such approval is not legally required." *In re Wheelabrator Technologies, Inc. Shareholders Litigation*, 663 A.2d 1194, 1202 n.4 (Del. Chanc. 1995). The term "stockholder ratification" thus does not, at least in classic form, describe stockholder approval of actions, such as a merger, that by statute cannot occur without stockholder approval. Id. Compare *Geier*, 671 A.2d at 1379 n.24 (distinguishing actions which by statute must be approved by stockholders from actions for which stockholder approval is sought but not required by statute).

101. Where directors approve a merger agreement without the requisite care, stockholder approval of the transaction has been held to extinguish the claim of breach of the fiduciary duty of care. See *Santa Fe*, 669 A.2d at 67; *Wheelabrator*, 663 A.2d at 1203; *Van Gorkom*, 488 A.2d at 889. Even where director action implicates the duty of loyalty due to conflicts of interest, stockholder approval of the transaction at issue, even where required by statute, has been held "either to change the standard of review to the business judgment rule, with the burden of proof resting upon the plaintiff, *or* to leave 'entire fairness' as the review standard, but shift the burden of proof to the plaintiff." *Wheelabrator*, 663 A.2d at 1203; *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 501 (Del. Chanc. 1990); *Van Gorkom*, 488 A.2d at 890; *Weinberger*, 457 A.2d at 703.

102. *Van Gorkom*, 488 A.2d at 893; *Weinberger*, 457 A.2d at 703; *Gerlach v. Gillam*, 139 A.2d 591, 595 (Del. Chanc. 1958).

parlance in corporate law.[103] In *Gerlach v. Gillam*, the defendant director, who by management contract exercised substantial influence over the affairs of the corporation, invoked stockholder approval[104] of agreements providing for the issuance of stock to corporations which he controlled. These issuances would give him "control of the corporation as a practical matter."[105] Defendant urged, and the court agreed, that fully informed stockholder ratification ordinarily validates even a self-dealing transaction.[106]

The ratification defense failed, however, because of a failure to satisfy the disclosure duty identified by the court—the defendant's "obligation to exhibit complete candor in dealings involving a conflict between his personal interests and those of [the corporation's] stockholders" generally.[107] This disclosure duty is merely the universally recognized duty of a fiduciary to establish that the trust beneficiary's consent was fully informed when the fiduciary relies on that consent to sustain a transaction approved by the fiduciary and challenged on the basis of self-dealing or waste.[108]

It was thus quite natural that after *Lynch*, the courts would invoke the "complete candor" language in defining the disclosure duty of a fiduciary relying on stockholder ratification of a transaction challenged as a breach of fiduciary duty. For instance, less than four months after *Lynch*, the Delaware Court of Chancery read *Lynch* broadly to require that "any contention that a proxy solicitation failed to completely inform stockholders must be given careful scrutiny."[109] The court recited this broad legal proposition, however, merely to determine whether the stockholders had effectively ratified stock option plan amendments challenged as a waste of corporate assets. Finding "complete candor" in the defendants' proxy statement, the

103. *Gerlach*, 139 A.2d at 593 ("I have no doubt concerning Mr. Gillam's [the "Comptroller," or dominant manager's] obligation to exhibit complete candor in dealings involving a conflict between his personal interests and those of United's stockholders."). Pease correctly identified *Gerlach* as the source of the "completo candor" terminology. 14 Del. J. Corp. L. at 449 (cited in note 22).

104. The stockholder approval was quite narrow: of the 520,200 shares outstanding, fewer than half (246,609 shares) were voted in favor of the challenged agreements, and 204,670 shares were voted against. *Gerlach*, 139 A.2d at 592.

105. Id.

106. Id. at 593 ("[W]here a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail.").

107. Id.

108. See, for example, Scott and Fratcher, 2A *Law of Trusts* § 170.1 at 317-18 (cited in note 49); George Gleason Bogert and George Taylor Bogert, *The Law of Trusts and Trustees* § 941 at 389 (Vernon Law Books, 2d ed. 1960). See Part V.B.

109. *Michelson v. Duncan*, 386 A.2d 1144, 1154 (Del. Chanc. 1978), aff'd in part and rev'd in part, 407 A.2d 211 (Del. 1979).

court concluded that the stockholders' ratification of the option plan amendments cured any lack of authority for the amendments.[110] As in *Lynch*, however, the court's language defining the fiduciary duty of disclosure was not limited to the context of the case.[111] This kind of language paved the way for later application of the fiduciary disclosure doctrine in entirely novel contexts, removed from the ratification setting in which the court appropriately insisted upon full disclosure as a condition to favorable judicial treatment resulting from stockholder approval.[112]

B. The Fiduciary Disclosure Duty of Directors Purchasing Stock on the Basis of Inside Information: The Proper Context of Lynch v. Vickers

Lynch has been described variously as "the genesis of Delaware law regarding disclosure obligations;"[113] "the modern impetus for the rule" of fiduciary disclosure;[114] the beginning of "[t]he principal evolution of the state law duty of disclosure;"[115] and "the seminal Delaware case" defining the fiduciary duty of "complete candor."[116] These characterizations of *Lynch* are undoubtedly correct if the reaction of the bench and bar to a case is what defines it as "seminal." *Lynch*'s broad language elicited a spate of claims of breach of fiduciary disclosure duty, including some which had foundation at most in the language, but certainly not the rationale, of the case.[117] To character-

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110. Id. at 1154-55.

111. See also *Schreiber v. Pennzoil Co.*, 419 A.2d 952, 957 (Del. Chanc. 1980) (noting that stockholder ratification of an allegedly wasteful transaction shifts to plaintiff the burden of persuasion, and relieves defendants of the "heavy burden of proving the intrinsic fairness of the transaction." The court explained further that in evaluating the efficacy of stockholder ratification, "[t]he only remaining question on the allocation of the burden of persuasion . . . is whether [the] stockholders were fully informed with complete candor of all the germane facts surrounding the disputed transaction." (citing *Lynch*, 383 A.2d at 278)).

112. See Part IV.

113. *Arnold*, 650 A.2d at 1276.

114. Brown, *Corporate Disclosure* § 9.02 at 9-4 (cited in note 22).

115. Solomon, *Corporations Law* at 890 (cited in note 30).

116. Oesterle and Palmiter, 79 Iowa L. Rev. at 565 (cited in note 30).

117. In one case, a corporation resisting a hostile tender offer argued that *Lynch* imposed upon the bidder "the duty of full and candid disclosure required of corporate management under Delaware law." *Servomation Corp. v. City Investing Co.*, 4 Del. J. Corp. L. 599, 604 (Del. Chanc. 1979). The court's rejection of that argument reflected a particularly thoughtful recognition of *Lynch* as evolutionary, not revolutionary, legal doctrine:

> [While *Lynch* was] a decision which spoke to the duty of candor imposed on an offeror in a tender offer context, I feel it significant to note that there the offeror was a majority shareholder tendering for shares in its subsidiary corporation. There are unquestionably fiduciary duties imposed on a parent in dealing with the minority shareholders of its subsidiary as our cases have held for years. However, the decision there was prem-

ize *Lynch* as seminal, however, may be misleading insofar as it suggests that *Lynch* announced some novel legal doctrine. To the contrary, that case is best understood not as the tap root of the fiduciary disclosure doctrine, but as merely a growth point, albeit a significant one.

The branch to which *Lynch* can fairly be traced is venerable. As almost anyone who has opened a corporation law casebook or treatise knows, there has been for over a century a conflict of authority as to whether in connection with a purchase of stock a director owes a fiduciary duty to disclose to the selling stockholder material facts which are not known or available to the selling stockholder but are known or available to the director by virtue of his position as a director.[118] The rationale for such a duty in this context is not hard to perceive. The presumptively superior knowledge and control of the corporate insider affords the insider such an advantage in buying the corporation's shares from, or selling them to, an outside or minority stockholder that fairness and fiduciary principles demand more thorough disclosure from the insider than the mere avoidance of intentionally false statements required by common law fraud doctrine.[119]

The precedents in this area, however, are at least superficially quite divergent in their evaluation of what disclosure fiduciary duty requires in the director stock purchase context. A supposedly "majority" rule disavows the existence of any general fiduciary duty in this context, and holds that directors have no special disclosure duties in the purchase and sale of the corporation's stock, and need only refrain from misrepresentation and intentional concealment of

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> ised on the fiduciary duties deriving from that relationship and not upon the requirements of the tender offer statute. That rationale does not fit here since [the bidder] has no such relationship with [the target].

Id. at 605.

118. Norman D. Lattin, *The Law Of Corporations* § 81 at 295 (Foundation Press, 2d ed. 1971). See also William L. Cary and Melvin Aron Eisenberg, *Cases and Materials on Corporations* 814-16 (Foundation Press, 7th ed. 1995); Robert W. Hamilton, *Cases and Materials on Corporations Including Partnerships and Limited Partnerships* 900-02 (West, 5th ed. 1994); R. E. Heinselman, Annotation, *Duty of Officer or Director of Corporation Toward One From Whom He Purchases Stock*, 84 A.L.R. 615 (1933).

119. See, for example, *Van Schaack Holdings, Ltd. v. Van Schaack*, 867 P.2d 892, 898 (Colo. 1994) (holding that directors, especially in closed corporations, have a duty of disclosure in order to "provide some degree of equalization of bargaining position . . ."); *Bailey v. Vaughan*, 359 S.E.2d 599, 604 (W. Va. 1987) ("[I]t must be shown that he [the director] possessed some special knowledge not available to the shareholder which enabled him to purchase the stock at a price that was lower than its actual value."); *Weinberger*, 457 A.2d at 711 ("[O]ne possessing superior knowledge may not mislead any steckholder by use of corporate information to which the latter is not privy.").

material facts.[120] The ostensibly opposing "minority" view broadly requires directors to disclose all material information bearing on the value of the stock when they buy it from or sell it to another stockholder.[121] Some courts have adopted a middle approach, known as the "special facts doctrine," that rejects any comprehensive fiduciary duty but allows that in some circumstances directors owe a duty to disclose material information to persons from whom they purchase the corporation's stock.[122] Such circumstances are identified, not altogether helpfully, as "special circumstances" or "special facts" that make the fiduciary's failure to disclose material information particularly unfair in connection with the purchase or sale of stock.[123]

Although the split of authority in this area is surely more semantic than real,[124] the progress of the Delaware courts in the area is the key to understanding the development of the fiduciary duty of disclosure. Properly understood, *Lynch* did not create a fiduciary duty of disclosure of universal application, requiring directors to disclose material corporate information in any and all contexts in which such disclosure might affect stockholder action. At most, *Lynch* represented the adoption in Delaware of the so-called "minority" view that a fiduciary who purchases the corporation's stock must disclose to the selling stockholder inside information that is material to the sale decision.

Before *Lynch*, the Delaware courts were said to have espoused the so-called "majority rule," under which directors are obliged, when they purchase their corporation's stock from an outside stockholder, only to avoid fraudulent misrepresentation and concealment. They are not broadly obliged to disclose material facts known to them

120. See Fletcher, 3A *Cyclopedia of the Law of Private Corporations* § 1168.10 at 397 (cited in note 61).

121. Id. § 1168.20 at 404.

122. Id. § 1171 at 409.

123. See, for example, *Van Schaack*, 867 P.2d at 896-97 (listing special circumstances that could give rise to a duty to disclose).

124. See *Bailey*, 359 S.E.2d at 603-605 (questioning the clarity of the traditional division of authority, and holding that "a director, who solicits a shareholder to purchase his stock and fails to disclose information not known to the shareholder that bears upon the potential increase in value of the shares, shall be liable to the shareholder either to have the sale rescinded or to respond in damages"). See generally Joel Seligman, *The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 Geo. L. J. 1083, 1093-1102 (1985); Sherwood E. Sterling, Note, *"Wherefore Art Thou, Fiduciary?": The Securities and Exchange Act of 1934 and the Common Law Fiduciary Duty of the Director*, 35 U. Colo. L. Rev. 410 (1963); A.A. Berle, Jr., *Publicity of Accounts and Directors' Purchases of Stock*, 25 Mich. L. Rev. 827, 833-34 (1927) (discussing the the origins of the "special circumstances" rule of fiduciary duty requiring disclosure by director/officer of material facts when a fiduciary relation with the buyer/seller exists).

through their corporate office.[125] Close review of the pre-*Lynch* Delaware cases, however, makes their nominal adherence to the "majority rule" appear less rigid, and the rule of law announced in *Lynch* something less than a wrenching departure from Delaware precedent.

In *Kors v. Carey*,[126] the opinion identified as adopting the "majority rule," the Court of Chancery addressed and rejected a claim by a regretful greenmailer whose shares had been purchased by the issuing corporation following a threat to the incumbents' control but had dramatically increased in market value following the repurchase.[127] Accused in a derivative suit of aiding and abetting greenmail,[128] United Whelan responded with a cross-claim against the issuer seeking to rescind the repurchase of the subsequently appreciated shares, on the grounds that the stock had been repurchased through "over-reaching" on the part of the directors.[129]

In this context, in which the alleged greenmailer sought to undo a sale of stock that had dramatically increased in value following the repurchase, the court explained its views about the fiduciary disclosure duty, or lack thereof, of directors purchasing stock from a stockholder. The court ruled that directors generally do not owe a fiduciary disclosure duty to individual stockholders from whom they purchase stock, and it limited any such duty to what it described as special cases.[130]

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125. Sterling, 35 U. Colo. L. Rev. at 417 (cited in note 124) (citing *Kors v. Carey*, 39 Del. Chanc. 47, 158 A.2d 136, 143 (1960), for the proposition that "Delaware follows the majority rule"). See also *Lank v. Steiner*, 43 Del. Chanc. 262, 224 A.2d 242, 244 (1966) (noting that the "special circumstances rule applies only when a director is possessed of special knowledge of future plans or secret resources and deliberately misleads a stockholder who is ignorant of them," and expressly approving the ruling in *Kors*).

126. 39 Del. Chanc. 47, 158 A.2d 136 (1960).

127. In the two years following the repurchase, the aggregate market value of the stock in question increased from $1,685,600 to over $2,700,000. *Kors v. United Whelan Corp.*, Fed. Secur. L. Rptr. (CCH) ¶ 90,970 (S.D.N.Y. June 7, 1960). In contrast, United Whelan's profit on the repurchase was only $50,000. Id. Adding insult to injury, United Whelan, after failing in its effort to undo the repurchase in the Delaware Court of Chancery litigation, was forced to pay almost $10,000 of its profits back to the issuer in settlement of a short-swing trading claim under section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). Id.

128. As explained by the Delaware Supreme Court, "[t]he term 'greenmail' refers to the practice of buying out a takeover bidder's stock at a premium that is not available to other shareholders in order to prevent the takeover." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956 n.13 (Del. 1985).

129. *Kors*, 158 A.2d at 142.

130. As the court explains:

> [I]t is only in special cases where advantage is taken of inside information and the like that the selling stockholder is afforded relief and then on the basis of fraud .... This case is clearly not one in which a buyer possessed with special knowledge of future plans or of secret and untapped resources deliberately misleads an ignorant stockholder ....

These pronouncements of law, however, were significantly broader than was necessary to arrive at the result reached. It is hardly stunning that United Whelan, a substantial business entity whose president was "skilled in the art of evaluating securities, a skill which he applied" to the acquisition of the "greenmailed" stock,[131] should not be favored with the protection of a fiduciary duty of disclosure designed for the protection of the informationally disadvantaged.[132] In any event, the only basis of United Whelan's nondisclosure claim had nothing to do with a failure to reveal information about the issuer's business. To the contrary, United Whelan apparently relied only on a claim, which it failed to establish at trial, that the issuer's broker misled United Whelan into believing that the purchaser was someone other than the issuer.[133] On its facts, therefore, *Kors* could not be considered a major defeat for advocates of fiduciary obligations more demanding than the "majority rule."

The approval of the "majority rule" in *Kors* was embraced by the Delaware Supreme Court six years later in *Lank v. Steiner*.[134] That case, however, was likewise not one that should have unduly alarmed critics of the "majority rule," at least in light of the facts as found by the trial court. *Lank* involved a close corporation in which the selling stockholder was also an officer of the corporation and was actually aware of the allegedly "special circumstance"—a third party's offer to purchase all of the corporation's stock at $600 per share—when he entered into the transaction subsequently challenged by his heirs.[135] The trial court had found as a fact, moreover, that the

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Id. at 143 (citations omitted).

Of course, the repurchase at issue in *Kors* did not involve acquisition of stock by the directors individually. Had the directors been purchasing stock for their own account and personally benefiting from the use of inside information, the court might well have drawn an analogy to *Brophy v. Cities Service Co.*, 31 Del. Chanc. 241, 70 A.2d 5 (1949), a case not cited in *Kors*. *Brophy* held that a fiduciary such as a director or officer must account to the corporation for all profits derived from use of "secret" information learned through his position as a fiduciary. Id. at 7-8. It would not have been an implausible leap to extend that duty to a case where the fiduciary's profit from "secret" information comes at the expense of an outside stockholder from whom he acquires stock. See Sterling, 35 U. Colo. L. Rev. at 417 (citod in note 124).

131. *Kors*, 158 A.2d at 143.

132. The rationale for protecting informationally disadvantaged stockholders is noted at note 119. A similar unwillingness to apply fiduciary disclosure duties in favor of a sophisticated institutional investor negotiating directly with management is reflected in *Trustees of General Electric Pension Trust v. Levenson*, 1992 Del. Chanc. LEXIS 43, *10-11 (Mar. 3, 1992) (dismissing a "duty of candor" claim absent "special circumstances that would state a claim for willful concealment under *Kors*").

133. *Kors*, 158 A.2d at 143.

134. 224 A.2d 242 (Del. 1966).

135. The transaction granted of an option to acquire the stock at book value, then $270 per share, after his death. Id. at 244.

seller had placed no confidence in or reliance upon his fellow officer, the purchaser.[136] Although the facts clearly could have been interpreted differently, it should not have been controversial to apply the "majority rule" in a case in which the selling stockholder was found not to have been informationally or procedurally disadvantaged relative to the purchasing fiduciary.

At any rate, even if the leaning of the Delaware courts toward the "majority rule" had been more than semantic, the legal atmosphere surrounding the *Lynch* litigation, less than ten years after *Lank*, foretold vigorous scrutiny of the responsibilities of majority stockholders to minority stockholders, and the likely demise of any doctrinal adherence to the "majority rule." Treatment of minority stockholders by majority stockholders, particularly in the area of going private transactions, was the subject of extensive litigation.[137] At the same time, the supposed reticence of the Delaware courts in enforcing corporate fiduciary duties was being vigorously criticized, particularly with regard to treatment of the fiduciary duty to disclose material facts in connection with a majority stockholder's purchase of corporate stock.[138] Moreover, any rigid adherence in the *Lynch* litigation to a "majority rule" rejecting such a duty would have faced another significant obstacle. By the time *Lynch* was decided in 1977, the composition of the Delaware Supreme Court had changed—Chief Justice Daniel F. Wolcott, the author of the majority opinion in *Lank*, had retired. He was replaced by Justice Daniel L. Herrmann, who had dissented vigorously in *Lank*. Justice William Duffy, who ultimately wrote the opinion in *Lynch*, had joined the Court.[139]

Perhaps recognizing the direction of prevailing discourse on the subject of majority stockholder fiduciary duties, the defendants in *Lynch*—the majority stockholder, Vickers Energy Corporation, and

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136. Id. at 245. Justice Daniel L. Herrmann dissented vigorously, urging his colleagues to reject this finding and determine that the purchaser's greater business experience and close personal relationship with the grantor of the option gave rise to "a relation of trust and confidence" and "a fiduciary relation . . . such as gives rise to a presumption of the invalidity of the stock options." Id. at 247 (Herrmenn, J., dissenting).

137. See, for example, *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir. 1974); *Albright v. Bergendahl*, 391 F. Supp. 754 (D. Utah 1974); *Jutkowitz v. Bourns*, No. CA00028, slip op. (Cal. App. Dept. Super. Ct. Nov. 19, 1975); *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36, 342 A.2d 566 (1975).

138. *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F.2d 317, 320-22 (5th Cir. 1959) (remarking that "[a]pparently Delaware imposes no fiduciary duty on the part of officers or directors or majority stockholders in buying stock from the minority or individual stockholders," and characterizing such a rule as "inequitable"). See also William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L. J. 663, 672-73 (1974); Arthur M. Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. Rev. 987 (1974).

139. See 306 A.2d at V nn.2b, 2c.

the directors of the subsidiary, TransOcean Oil, Inc.—did not dispute that they owed the minority stockholders of TransOcean a "duty of complete frankness" in connection with a tender offer by Vickers for the minority shares.[140] The trial judge in *Lynch*—Chancellor William Marvel, who had decided *Kors*—likewise acknowledged that the majority stockholder owed a fiduciary duty of "complete candor" and that such a duty paralleled the duty owed by corporate directors.[141]

Not surprisingly, the Delaware Supreme Court readily agreed with this articulation of a fiduciary duty of disclosure.[142] In identifying a "fiduciary duty . . . which required 'complete candor' in disclosing fully 'all of the facts and circumstances surrounding the tender offer,'"[143] the Delaware Supreme Court did not truly break new legal ground. *Lynch* thus aligned Delaware with jurisdictions rejecting the "majority rule" in favor of a rule recognizing a fiduciary duty on the part of directors, officers and controlling stockholders to disclose material facts, learned through their position with the corporation, to outside stockholders when buying stock from them.[144]

After *Lynch*, then, Delaware law at a minimum imposed a fiduciary disclosure duty on majority stockholders acquiring stock from minority stockholders. Just as clearly, Delaware law required fiduciaries to disclose all material facts to stockholders where they rely on stockholder consent to a self-dealing transaction.[145] Naturally, then, a most emphatic articulation of fiduciary disclosure duty appeared in a case combining both of these elements. That is, a case in which a majority stockholder relied upon a favorable vote of the mi-

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140. *Lynch*, 383 A.2d at 281.

141. As Chancellor Marvel explains:

> [I]n situations in which the holder of a majority of the voting shares of a corporation, as here, seeks to impose its will upon minority stockholders, the conduct of such majority must be tested by those same standards of fiduciary duty which directors must observe in their relations with all their stockholders, ... [T]he majority stockholder here, namely Vickers, had a duty to exercise complete candor in its approach to the minority stockholders of TransOcean for a tender of their shares, namely a duty to make a full disclosure of all of the facts and circumstances surrounding the offer for tenders, including the consequence of acceptance and that of refusal . . . .

Lynch, 351 A.2d at 573.

142. To be sure, the court's citation of *Lank* as "applying the 'special circumstance rule,'" see *Lynch*, 383 A.2d at 279, seems revisionistic since *Lank* limited that rule to cases of deliberate deception. *Lank*, 224 A.2d at 244.

143. *Lynch*, 383 A.2d at 279.

144. *Mansfield Hardwood Lumber Co.*, 268 F.2d at 319; *Agatucci v. Corradi*, 327 Ill. App. 153, 63 N.E.2d 630, 632 (1945); *Jacobson v. Yaschik*, 249 S.C. 577, 155 S.E.2d 601, 606 (1967); *Shermer v. Baker*, 472 P.2d 589, 593-94 (Wash. App. 1970). But see *Trustees of General Electric Pension Trust*, 1992 Del. Chanc. LEXIS 43 at *11 (applying *Kors*'s requirement of "willful concealment" to a claim that management failed to disclose an allegedly planned restructuring during arm's length settlement negotiations with a sophisticated institutional investor).

145. See Part III.A.

nority stockholders to obtain approval of a merger in which the minority's shares were converted into cash and were thereby effectively acquired by the majority stockholder.

This case was *Weinberger v. UOP, Inc.*[146] It involved a merger in which the 50.5% majority stockholder acquired the shares of the 49.5% minority in a cash out merger conditioned upon the approval by a majority of the minority shares voting on the merger,[147] and defendants' reliance on that vote to establish the validity of the transaction.[148] Applying what it described as "the obvious duty of candor required by *Lynch*," the Delaware Supreme Court ruled in sweeping language that "one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy."[149] Having found the disclosures to the minority stockholders inadequate, the court found the approval meaningless.[150]

Notwithstanding the breadth of the language in *Lynch* and *Weinberger*, those cases should not have been understood to require directors to disclose to stockholders all material facts in any and all contexts in which those facts might be significant to stockholders and regardless of the directors' self-interest or lack thereof. Rather, the disclosure requirements articulated in *Lynch* and *Weinberger* should be applied only to transactions in which directors, officers, or controlling stockholders acquire or sell stock of the corporation and profit, to the detriment of the outside stockholders, while in possession of material non-public information about the business of the corporation derived from their positions with the corporation. As discussed fur-

146. 457 A.2d 701 (Del. 1983). See also *Fisher v. United Technologies Corp.*, 6 Del. J. Corp. L. 380 (Del. Chanc. 1981), a case which invoked *Lynch* but, finding the proxy statement disclosures adequate, granted summary judgment against a minority stockholder cballenging a casb out merger by an acquiror which was a 49% "controlling stockholder," at the time of the merger. The merger was structured to require approval of a majority of the public minority stockholders. Id. at 383.

147. The architects of the merger attempted to strengthen the force of this "majority of the minority" vote requirement by insisting that two-thirds of the outstanding shares (including the 50.5% stockholder's shares), rather than the bare majority required by statute, be voted in favor of the merger. *Weinberger*, 457 A.2d at 707. Thus, approval by at least 32% of the outstanding minority shares was a precondition to effectiveness of tbe merger.

148. Id. at 703 ("[W]here corporate action has been approved by an informed vote of a majority of the minority shareholders, we conclude that the burden entirely shifts to the plaintiff to show that the transaction was unfair to the minority.").

149. Id. at 711 (citing *Lank*, 224 A.2d at 244). The fact that *Weinberger* followed *Lynch* in misreading *Lank* to have established the broad proposition tbat "one possessing superior knowledge may not mislead any steckholder by use of corporate information to which the lattor is not privy" illustrates the influential force of the *Lynch* opinion. See text accompanying note 147.

150. *Weinberger*, 457 A.2d at 712 (citing *Cahall v. Lofland*, 12 Del. Chanc. 299, 114 A. 224 (Del. Chanc. 1921)).

ther below,[151] this reading of *Lynch* amply explains the basis of many subsequent opinions, including *Weinberger* itself, which purport to stand for a broader fiduciary duty of disclosure.

IV. FROM RATIFICATION TO REIFICATION: *SMITH V. VAN GORKOM* AND ITS PROGENY

A. Smith v. Van Gorkom *as a Disclosure Case*

Through and including *Weinberger*, the decisions of the Delaware Supreme Court can be traced to one or more traditional strands of fiduciary disclosure doctrine. In its next major pronouncement on the subject after *Weinberger*, however, the Delaware Supreme Court extended the logic and lilt of the language in *Lynch* to announce a fiduciary disclosure duty in a context outside of any of those traditional strands. The broadly worded but abstract language of the earlier opinions finally found embodiment in what was, to the directors of a large publicly held corporation, a painfully concrete, although novel, form.

This reification occurred in the controversial opinion in *Smith v. Van Gorkom*.[152] That opinion is best known for its finding that the

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151. See Part V.B.

152. 488 A.2d 858 (Del. 1985). In fairness, one should observe that the Delaware Court of Chancery, even before *Smith v. Van Gorkom*, carried the broad "duty of candor" language of *Lynch* inte uncharted legal territory. While most of the pre-*Van Gorkom* court of chancery cases can be viewed as stock purchase/freeze-out cases (like *Lynch*) or ratification cases (like *Gerlach* and *Michelson*), four court of chancery opinions invoke the *Lynch* duty of candor language to evaluate proxy disclosures in other contexts. *Thompson v. Enstar Corp.*, 509 A.2d 578, 584 (Del. Chanc. 1984) (denying a preliminary injunction against a proposed merger, but reciting a (satisfied) "requirement of a full and complete disclosure, with complete candor, of all the material information which is needed by a shareholder of Enstar to make an informed decision"); *Cavalcade Oil Corp. v. Texas American Energy Corp.*, 9 Del. J. Corp. L. 417, 418-19 (Del. Chanc. 1984) (enjoining implementation of charter amendment providing for a staggered board, where proxy statement incorrectly, but inadvertently, exaggerated steckholders' ability to undo the amendment later); *Weinberger v. United Financial Corp. of California*, C.A. No. 5915, slip op. (Del. Chanc. Oct. 13, 1983) (addressing claims that the proxy statement was false and misleading due to misstatements and omissions of material fact); *American Pacific Corp. v. Super Food Services, Inc.*, 8 Del. J. Corp. L. 320, 325-26 (Del. Chanc. 1983) (relying on stockholder confusion concerning the nature and vote required for adoption of certain defensive charter provisions as a basis for a finding of irreparable injury justifying a preliminary injunction). See also *Edelman v. Salomon*, 559 F. Supp. 1178, 1184-85 (D. Del. 1983) (invoking *Lynch* as a grounds for nullifying a charter amendment eliminating cumulative voting, based on material omissions in the proxy statement). As discussed below in Part V.C, the three cases in which a preliminary injunction was granted, *Cavalcade* and *American Pacific*, or sought, *Enstar*, fit logically into the analytical framework suggested in this Article, as does the *Edelman* case involving rescission.

directors of Trans Union Corporation, all concededly disinterested and independent, breached their fiduciary duty of care in approving an arm's length merger in which Trans Union would be acquired at a cash price forty-five percent higher than the prevailing price of the stock on the New York Stock Exchange.[153] The fiduciary duty of disclosure figured importantly in the case, however. The court devoted considerable effort to evaluating whether the disclosures to the Trans Union stockholders were adequate.[154]

It would be intellectually convenient to attribute that effort solely to the court's evaluation of the directors' defense of stockholder ratification. As previously discussed, the invocation of stockholder ratification as a defense is a conventional occasion for judicial review of the sufficiency of disclosure.[155] Indeed, it is possible to view *Van Gorkom* through the lens of ratification doctrine. The court indicated that informed stockholder approval of the merger would have extinguished altogether any claim of breach of the directors' duty of care in approving the merger agreement and submitting it to the stockholders for approval.[156] Necessarily, then, the court examined the suffi-

153. *Van Gorkom*, 488 A.2d at 874-84. The comments elicited by this aspect of the opinion were formidable in volume and tone. See, for example, Daniel R. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 Bus. Law. 1437, 1455 (1985) (stating that *Van Gorkom* was "surely one of the worst decisions in the history of corporate law"); William T. Quillen, Trans Union, *Business Judgment, and Neutral Principles*, 10 Del. J. Corp. L. 465, 470 (1985) (arguing that the *Trans Union* opinion "is burdened by overkill and by needless, and often erroneous, legal and factual excess"); Arthur M. Borden, *First Thoughts on Decision in Delaware on* Trans Union, N.Y. L. J. 1 (Feb. 25, 1985); Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 Bus. Law. 1, 1 (1985) (noting that commentators viewed the decision as "atrocious"); Leo Herzel and Leo Katz, Smith v. Van Gorkom: *The Business of Judging Business Judgment*, 41 Bus. Law. 1187, 1189 (1986) (arguing that *Van Gorkom* "rests on widespread fallacy").

Even several years after it was decided, *Van Gorkom* prompted scholars to reexamine the case to divine some rationale more satisfactory than the "ill-fitting" duty of care theory invoked by the court. Alan R. Palmiter, *Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence*, 67 Tex. L. Rev. 1351, 1354-55 (1989) (suggesting a director "duty of independence" as a superior rationale); Jonatban R. Macey and Geoffrey P. Miller, Trans Union *Reconsidered*, 98 Yale L. J. 127, 128 (1988) (viewing *Van Gorkom* as a takeover case enhancing director authority to resist hostile tender offers).

154. *Van Gorkom*, 488 A.2d at 889-93.

155. Part III.A.

156. As the court notes:

> The parties tacitly agree that a discovered failure of the Board to reach an informed business judgment in approving the merger constitutes a voidable, rather than a void, act. Hence, the merger can be sustained, notwithstanding the infirmity of the Board's action, if its approval by majority vote of the shareholders is found to have been based on an informed electorate.

Van Gorkam, 488 A.2d at 889. In more recent challenges to mergers, the courts and the litigants accepted this conclusion, agreeing that "if the . . . shareholder vote was fully informed, the effect of that informed vote would be to extinguish the claim that the . . . board failed to ciency of the disclosures, citing conventional ratification law.[157] When the court described the directors' disclosure obligation as "their original duty of knowing, sharing, and disclosing information that was material and reasonably available for discovery," it was still possible to view that "original duty" of disclosure as not really "original" or free-standing but merely ancillary to the holding that immediately ensued: that the directors' defense of stockholder ratification failed because the Board failed to meet its burden "to establish that the shareholder approval resulted from a fully informed electorate."[158]

It is unfortunate, then, if only for reasons of analytical clarity, that in a facet of the opinion much less heralded than its duty of care ruling, *Van Gorkom* took one further, significant step to enunciate an independent duty on the part of directors to disclose material information when submitting a merger proposal to stockholders and to authorize a *post hoc* damages remedy against directors who fail to fulfill that duty.[159] That further step came when the court, summarizing its holdings, ruled that the Trans Union directors breached their fiduciary duty not only by their failure to be adequately informed, but also "by their failure to disclose all material information such as a reasonable stockholder would consider important" in voting on the merger proposal.[160]

Thus, the majority found a breach of fiduciary duty, and endorsed a damages remedy against the directors, not only in regard to their lack of care, but also separately in regard to their failure to disclose material facts to the stockholders. Any doubt that *Van Gorkom* took this additional step was eliminated by the Delaware Supreme Court in *Cinerama, Inc. v. Technicolor, Inc.*[161] The court noted that in *Van Gorkom* the Trans Union directors had violated not only their duty of care, but also their duty of disclosure.[162]

From where did this independent, reified duty of disclosure, and its concomitant damages remedy, emerge? The few cases *Van Gorkom* cites in this context are all either plain ratification cases or cases where a majority stockholder acquires stock from minority

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exercise due care in negotiating and approving the merger." *Wheelabrator*, 663 A.2d at 1200. See also *Santa Fe*, 669 A.2d at 67.

157. *Van Gorkam*, 488 A.2d at 889-90 (citing *Michelson*, 407 A.2d at 211, *Gerlach*, 139 A.2d at 591, and *Schreiber*, 419 A.2d at 591, as well as *Gottlieb v. Heyden Chemical Corp.*, 91 A.2d 59 (Del. 1952), all conventional ratification cases).

158. *Van Gorkom*, 488 A.2d at 893.

159. Id.

160. Id.

161. 663 A.2d 1156 (Del. 1995).

162. Id. at 1166.

stockholders.[163] Those cases, however, do not even establish the existence of a comprehensive duty on the part of directors to disclose all material facts whenever they seek stockholder action, much less a money damages remedy against directors who are found to have failed to discharge that duty. This is not to say that such a duty does not exist.[164] The point here is simply that *Van Gorkom* failed to supply any precedent or rationale to support the existence of such a duty.

B. The Fiduciary Disclosure Concept Broadens: Further Repercussions From Lynch *and* Van Gorkom

Given the breadth of *Van Gorkom*'s duty of disclosure, stockholder plaintiffs would inevitably seek to apply that abstract fiduciary disclosure obligation in unprecedented settings. And just as inevitably, trial judges dealing with expansive appellate court language would find it more comfortably appeal-proof to interpret fiduciary disclosure obligations broadly, especially if they were satisfied that there was in fact no material nondisclosure.[165]

Van Gorkom's extension of fiduciary disclosure duty to the solicitation of proxies in a proposed arm's length merger was duly followed by the court of chancery.[166] Indeed, the sweeping rhetoric of *Van Gorkom* and *Lynch* was cited in other settings in which a fiduciary disclosure duty was applied as a basis for relief where it had not previously been recognized to exist. If a fiduciary duty required directors to disclose all material facts when presenting a merger proposal to stockholders for a vote, inevitably this duty would also require such disclosure when directors present any other matter for a stockholder vote. Hard on the heels of *Van Gorkom*, the court of chancery so held,

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163. 488 A.2d at 889-93 (citing *Lynch*, *Weinberger*, *Michelson*, *Schreiber*, *Gerlach*, and *Gottlieb*).

164. Indeed, as developed below, this Article argues that such a duty does exist. See Part V.C.

165. The history of the Delaware cases enunciating a fiduciary "duty of candor" or duty of disclosure is replete with broad statements of the duty followed by findings that the duty was not violated, or could not in any event result in director liability. See, for example, *Kahn v. Roberts*, 1996 Del. LEXIS 275, *1 (July 25, 1996); *Williams v. Geier*, 671 A.2d at 1379; *Santa Fe*, 669 A.2d at 66-67; *Kahn*, 669 A.2d at 88-89; *Cinerama*, 663 A.2d at 1176; *Arnold*, 650 A.2d at 1270; *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 372 (Del. 1993); *Stroud*, 606 A.2d at 88; *Rosenblatt*, 493 A.2d at 945; *Michelson*, 407 A.2d at 222; *Loudon v. Archer-Daniels-Midland Co.*, 1996 Del. Chanc. LEXIS 12, *1 (Feb. 20, 1996); *Emerald Partners v. Berlin*, 1995 Del. Chanc. LEXIS 128 at *1 (Sep. 22, 1995); *Zirn v. VLI Corp.*, 1995 Del. Chanc. LEXIS 74, *1 (June 12, 1995), aff'd, 1996 Del. LEXIS 320 (Del. Aug. 23, 1996); *Lewis v. Leaseway Transportation Co.*, 1990 Fed. Secur. L. Rep. (CCH) ¶ 96,268; *In re J.P. Stevens & Co., Inc. Shareholders Litigation*, 542 A.2d 770, 784 (Del. Chanc. 1988); *Schreiber*, 419 A.2d at 957-58.

166. See, for example, *In re Anderson, Clayton*, 519 A.2d at 689-90 (applying *Van Gorkom* standard te enjoin merger with subsidiary of employer stock ownership plan).

in *Lacos Land Co. v. Arden Group, Inc.*[167] In *Lacos Land*, the court relied on a breach of the "duty of candor" as an alternative basis for a preliminary injunction against implementation of a charter amendment proposal that would have established a dual class equity structure designed to buttress the control of the corporation's chief executive officer, who held twenty-one percent of the outstanding stock.[168] Citing *Van Gorkom* and *Lynch* and carrying the language of those cases to their logical end, the court reaffirmed the extensive sweep of the "duty of candor."[169]

The court in *Lacos Land* did not, and was not called upon to, evaluate the entire range of remedies for breach of this fiduciary duty. For purposes of granting a preliminary injunction, however, the court found the likelihood of such a breach, without regard to whether the omitted material fact was omitted from the proxy statement out of neglect, malice, or on good faith deliberation including advice of counsel.[170]

Soon after *Lacos Land*, the wave from *Lynch* and *Van Gorkom* traveled still further, into an area in which the directors were not literally seeking stockholder action: management recommendations in a Schedule 14D-9 submitted to stockholders in connection with a third-party tender offer.[171] In *Weinberger v. Rio Grande Industries, Inc.*,[172] suit was brought against Rio Grande and its directors by a class of stockholders as of the date on which a third party bidder, acting under an acquisition agreement approved by the board of Rio Grande, commenced a cash tender offer.[173] The court of chancery denied defendants' motion for summary judgment, finding that information about the risks associated with a pending Interstate Commerce Commission proceeding might have been material, and the failure to include that information in the Schedule 14D-9 thus may have violated what it characterized as a well-settled fiduciary duty of

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167. 517 A.2d 271 (Del. Chanc. 1986).

168. Id. at 276.

169. As the *Lacos Land* court explains

> It is, of course, well established in our law that an element of the fiduciary duty that directors owe to shareholders is the duty, arising when the board is required or elects to seek shareholder action, to disclose fully and fairly pertinent information within the board's control.

Id. at 279.

170. The omitted fact was a significant but quite technical elaboration of whether the CEO/21% stockholder would be a "Restricted Person" for purposes of a business combination supermajority vote requirement in the certificate of incorporation. Id. at 279-81.

171. Id. at 279.

172. 519 A.2d 116 (Del. Chanc. 1986).

173. Id. at 119.

the directors to disclose all facts germane to a transaction in which stockholder action is contemplated.[174]

The *Rio Grande* court cited no authority for applying this "well-settled rule" to a damages action against directors who lacked any personal interest in the transaction and were not even taking action under state law to place a matter before the stockholders for their consideration or action.[175] The directors were merely providing information, as required by federal law, in response to an initiative by a third party.[176] Again, as in *Lacos Land,* the court's opinion did not examine—and presumably considered irrelevant—whether the directors' omission of the potentially material information about the ICC proceeding was negligent, malicious or the result of good faith deliberation, including reliance on counsel.

From *Rio Grande,* it was not an implausible leap across the border to extend the fiduciary duty of disclosure to *any* situation in which a public statement approved by directors might affect the stockholders' decision whether to sell their shares, or buy more shares, even in the absence of a pending tender offer. That leap occurred, albeit with some notable restraint, in the court of chancery's opinion in *Marhart, Inc. v. Calmat Co.*[177] In *Marhart* the court concluded that corporate directors, as fiduciaries, owed the stockholders a duty, not owed to nonstockholders, as it turned out,[178] "to disclose all

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174. Id. at 121 (stating that it is "the now well-settled rule of Delaware law that corporate directors owe the corporation's stockholders a fiduciary duty to disclose all facts germane to a transaction involving stockholder action, in an atmosphere of complete candor"). See also *Zirn v. VLI Corp.*, 18 Del. J. Corp. L. 803, 813-14 (Del. Chanc. 1992), rev'd on other grounds, 621 A.2d 773 (Del. 1993) (holding that proof of a mischaracterization in a Schedule 14D-9 of the disinterested directors' reason for approving a revised merger agreement "might have established a breach of the . . . directors' fiduciary duty of disclosure").

Despite the broad language in *Rio Grande* mandating that directors assure that all facts material to pending stockholder action be disclosed, directors have not been found obliged to correct the misstatements or omissions of a third party tender offeror. See *Citron v. Fairchild Camera and Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989); *Solash v. Telex Corp.*, 1987-1988 Fed. Secur. L. Rptr. (CCH) ¶ 93,608 at 97,729 (Del. Chanc. Jan. 19, 1988).

175. The only authorities the court did cite in this regard were *Lynch*, which the court viewed as "the appropriate analytic starting point" for any "claim of material nondisclosure," *Van Gorkom*, and *Rosenblatt*, a case addressing a cash-out merger with a majority stockholder and, thus, analytically parallel to *Weinberger*. *Rio Grande*, 519 A.2d at 121.

176. See note 66. To be sure, one could argue that the directors in *Rio Grande* were directly involved in presenting the tender offer to the stockholders because that offer proceeded pursuant to a merger agreement which the directors had approved. There is nothing in the *Rio Grande* opinion, however, to limit the fiduciary disclosure duty to this context, or to suggest that such a duty would not apply equally to a Schedule 14D-9 filed in relation to a tender offer not agreed to in advance by the directors.

177. *Marhart*, 18 Del. J. Corp. L. at 330. *Marhart* was a class action seeking damages based on a press release misleadingly exaggerating the benefits of a proposed defensive restructuring in response to a takeover bid. Id. at 333-35.

178. *Marhart*, 18 Del. J. Corp. L. at 740.

material facts when they undertake to give out statements about the business to stockholders."[179]

Curiously, as previously discussed,[180] the court relied on a statute repealed twenty-five years earlier as the source of this duty. By virtue of that reliance, however, the court sharply limited the scope of any damages claim. By invoking the repealed statute, the court simultaneously adopted the elements of the cause of action embodied in that statute, namely (1) an affirmative misrepresentation, (2) "knowingly made" by the directors, (3) as a result of which (4) plaintiff suffered damages.[181] In this context, at least, the fiduciary duty of disclosure had taken on the falsity, scienter, reliance/causation and damages requirements that were notably absent in earlier cases discussing the doctrine.[182]

C. *Attempts to Limit and Further Define the Fiduciary Duty of Disclosure: From* Stroud *to* Arnold

Even before *Marhart*, the Delaware courts had begun to recognize that the fiduciary duty of disclosure was not unlimited, and to cut back on the theoretical scope of the duty. In *Raskin v. Birmingham Steel Corp.*,[183] for instance, the court of chancery addressed a claim that the directors' fiduciary duty required them, in the absence of any public statement or filing, to disclose adverse financial developments that might reduce the likelihood that a previously announced merger agreement would be consummated. The court summarily rejected the notion that such a fiduciary disclosure duty existed, articulating the view that such a disclosure duty is limited to cases where the directors seek stockholder action in the form of a vote, purchase or sale of stock, or "otherwise."[184] Paralleling the

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179. *Marhart*, 18 Del. J. Corp. L. at 336 (citing *Kelly*, 254 A.2d at 71).

180. See note 72.

181. *Marhart*, 18 Del. J. Corp. L. at 336.

182. In a not entirely dissimilar case decided just a few months before *Marhart*, the court of chancery declined te dismiss claims of breach of fiduciary duty of disclosure brought on behalf of a class of stockholders who purchased stock in a dividend reinvestment plan following allegedly material misstatements or omissions in SEC periodic reports. *Wiener v. Southern Co.*, 18 Del. J. Corp. L. 372, 381-82 (1993). As the court described the matter, however, the denial of the motion to dismiss may have resulted from defendants' failure to articulate and define a basis for dismissal under Delaware law, rather than from the court's conviction that a fiduciary duty claim had been established. Id. at 382.

183. 1990-1991 Fed. Secur. L. Rptr. (CCH) ¶ 95,668 (Del. Chanc. Dec. 4, 1990).

184. As the court explains:

> [S]ince the company did not seek the vote of the shareholders, offer them an exchange, or otherwise seek any action from them, the only possible breach of candor claim would necessarily rest upon the existence of a duty to inform the market accurately of material

federal securities laws doctrine, the court reasoned that under state law, "business reasons" of confidentiality might well permit the corporation to refrain from disclosing even information that would be highly material to a stockholder's decision to sell stock or buy additional shares.[185]

The articulation of the fiduciary disclosure duty in *Raskin*—limiting it to situations in which directors seek stockholder action—was a reasonably fair distillation of the Delaware case law, although not entirely consonant with the cases establishing a "duty of candor" where directors, although not placing a matter before stockholders for their action, make Schedule 14D-9 disclosures in response to an arm's length tender offer.[186] Even though lack of precedent may be a healthy reason for rejecting a proposed common law rule, however, the court in *Raskin* offered no affirmative authority or rationale, other than the interest in preserving the confidentiality of sensitive information, to justify the limitation it articulated.[187] In fact, a fiduciary duty to disclose material information to stockholders when the directors realize that the stockholders are buying, or refraining from selling, stock despite still undisclosed highly adverse corporate information is an entirely plausible corollary of the general duty of trustees to disclose material facts which the trustee knows may affect the actions and interests of the *cestui que trust*.[188]

> developments. No Delaware case establishes such a duty to my knowledge and, in my opinion, no such duty exists. The state law duty of candor arises when the board elects to or has a duty to seek shareholder action; in tbat setting the board is under a duty to make shareholder action meaningful by supplying information relevant to the question presented. If the board does not seek shareholder action at a meeting, through consent, in a tender or exchange offer, or otberwise, it has, in my opinion, no distinctive state law duty to disclose material developments with respect to the company's business.

Id. at 98,131-32.

185. Id. at 98,132 ("There are good business reasons to permit the company to treat material information confidentially."). Similar logic has persuaded courts that issuers are under no federal law duty to disclose material information in the absence of an explicit affirmative disclosure obligation, or when necessary to make a disclosure not materially misleading. See generally Brown, *Corporate Disclosure* § 3.01 at 3-3 (cited in note 22); Marc I. Steinberg and Robin M. Goldman, *Issuer Affirmative Disclosure Obligations—An Analytical Framework for Merger Negotiations, Soft Information and Bad News*, 46 Md. L. Rev. 923 (1987).

186. See text accompanying notes 172-76.

187. One could, alternatively, accommodate a legitimate business need for preserving the confidentiality of material information by requiring disclosure of all material information, subject to the right of directors, in their business judgment, to refrain from disclosure when they make a considered determination that disclosure would be contrary to the best interests of the corporation and its stockholders. See Brown, *Corporate Disclosure* § 9.03[7] at 9-26 and § 9.04 at 9-28 (cited in noto 22).

188. *Rettinger v. Pierpoint*, 145 Neb. 161, 15 N.W.2d 393, 412 (1944) ("'It is the duty of a trustee to fully inform the *cestui que trust* of all facts relating to the subject-matter of the trust which come to the knowledge of the trustee and which are material for the *cestui que trust* to

Soon after *Raskin*, in any event, the Delaware Supreme Court had several occasions to evaluate and limit the reach of the fiduciary duty of disclosure that its earlier opinions in *Lynch* and *Van Gorkom* had so stirringly articulated.

1. *Stroud v. Grace*

Ultimately decided by the Delaware Supreme Court in 1992, *Stroud v. Grace*[189] involved a closely held corporation controlled by family members owning over 50% of the outstanding stock.[190] Dissident stockholders owning 17% of the stock brought suit challenging various charter amendments relating to corporate governance.[191] Plaintiffs advanced several theories in support of their challenge to the amendments, including a claim that the directors owed, but failed to fulfill, a duty of complete candor in connection with the stockholder vote on the amendments.[192] Plaintiffs advanced this theory despite the facts that (1) no proxies were solicited by management, (2) directors controlling a majority of the stock supported the amendments and could provide the necessary stockholder vote without the support of any other stockholders, and (3) the dissenting stockholders had no investment decision to make in connection with approval of the challenged amendments.[193] In short, the directors

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know for the protection of his interests.' ") (quoting *First Trust Co. v. Carlsen*, 261 N.W. 333 (Neb. 1935)). Moreover, the Restatement (Second) of Trusts § 173 cmt. a (1959) provides:

> Even if the trustee is not dealing with the beneficiary on the trustee's own account, he is under a duty to communicate to the beneficiary matorial facts affecting the interest of the beneficiary which he knows the heneficiary does not know and which the beneficiary needs to know for his protection in dealing with a third person with respect to his interest. Thus, if the beneficiary is about to sell his interest under the trust to a third person and the trustee knows that the beneficiary is ignorant of facts known to the trustee which make the interest of the beneficiary much more valuable than the beneficiary believes it to be the trustee is under a duty to the beneficiary to inform him of such facts.

See also Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1250 n.15 (1983) ("Among a fiduciary's standard 'form' duties are the duties to . . . give information needed by the principal."); Brown, *Corporate Disclosure* § 9.04 at 9-29 (cited in note 22) (noting that since "the duty of candor arises out of a fiduciary's obligation to shareholders," limiting the obligation to avoiding false or misleading statements and omissions, rather than extending it to require affirmative disclosures of material facts, "does not follow analytically").

189. 606 A.2d 75 (Del. 1992).

190. Id. at 79.

191. These amendments included provisions defining qualifications for service on the board, and imposing a 75% stockholder vote requirement for new issuances of common stock. *Stroud v. Grace*, 16 Del. J. Corp. L. 1588, 1593-94 (Del. Chanc. 1991).

192. Id. at 1597.

193. Unlike the Model Business Corporation Act and the corporate statutes of several states, the Delaware General Corporation Law does not provide an appraisal remedy in respect of amendments to the certificate of incorporation. Compare, 8 Del. Code Ann., §§ 242 and 262(b)

were charged with having breached a fiduciary duty of candor by failing to disclose information to stockholders in a context in which the only conceivable purpose of disclosure would have been to provide a basis for evaluating the merits of a motion for a preliminary injunction against implementation of the charter amendments.

In an early phase of the controversy, the Delaware Supreme Court dismissed an appeal as unripe.[194] In analyzing the ripeness issue, however, the court announced a ringing endorsement of the concept, previously expressed in *Lacos Land* and *Raskin*, that directors seeking stockholder action have a fiduciary duty to disclose to stockholders all facts material to that action that the directors know or can reasonably obtain through their control of the corporation.[195] This duty applies to stockholder actions modifying rules of corporate governance, as well as to business transactions.[196]

Not unreasonably, the court of chancery on remand accepted these admonitions at face value, and found that the directors could not avoid their disclosure duty by determining not to solicit proxies in

with 3 Model Bus. Corp. Act Ann. § 13.02(4) (noting that thirty-six states allow appraisal rights in connection with at least certain charter amendments).

In the charter amendment context, the basic relevant facts—namely, what the proposed amendment says—are ordinarily available to stockholders. This context is distinguishable from the context of a cash-out merger, where the minority stockholders, usually lacking access to internal corporate performance and projection data, are at an informational disadvantage in evaluating whether the merger price is fair, and whether to seek statutory appraisal or other post-merger relief. See *In re USA Cafes, L.P. Litigation*, 600 A.2d 43, 54 (Del. Chanc. 1991) ("Because the Prospectus itself discloses that a shareholder vote was neither necessary nor sought on the reorganization of the Nevada corporation, I will dismiss the state law breach of duty of candor claims made with respect to it. Neither plaintiffs nor any class member could have been injured by the alleged defect as they had neither a right to vote nor a right to dissent and seek appraisal."). But see *Shell Petroleum*, 606 A.2d at 114 (holding that a majority stockholder effecting a short-form merger "bears the burden of showing complete disclosure of all material facts relevant to a minority shareholder['s] decision whether to accept the short-form merger consideration or seek an appraisal"); *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 171 (Del. 1991) (holding that under Alaska law, an 88.4% stockholder acquiring minority shares in a merger owes a fiduciary duty to disclose material facts, despite ability to satisfy stockholder vote requirement unilaterally); *Seagraves v. Urstadt Property Co., Inc.*, 1996 Del. Chanc. LEXIS 36, *18 (Apr. 1, 1996) ("Delaware law imposes a fiduciary obligation to disclose all material information that would affect a minority stockholder's decision whether to accept the merger consideration or to seek an appraisal or other available litigation remedy."); *In re Radiology Associates, Inc. Litigation*, 1990 Del. Chanc. LEXIS 58, *34 (May 16, 1990) ("Shareholders . . . rely on directors meeting their duty of candor in electing to accept the merger consideration, seek appraisal or seek an individual post-merger action."); *Glassman v. Wometco Cable TV, Inc.*, 1989 Del. Chanc. LEXIS 1, *1 (Jan. 6, 1989).

194. *Stroud v. Milliken Enterprises, Inc.*, 552 A.2d 476, 479-80 (Del. 1989).

195. Id. at 480 ("[W]hen a board of directors 'is required or elects to seek shareholder action,' it is under a duty 'to disclose fully and fairly pertinent information within the board's control.' ") (quoting *Lacos Land*, 517 A.2d at 279).

196. Id.

connection with adoption of the questioned charter amendments.[197] Moreover, the court continued, the "duty of candor" requires that the necessary material information be disclosed sufficiently in advance of the stockholder meeting so that stockholders can adequately evaluate the significance of that information to the matters to be voted upon.[198]

Interestingly, however, the court appeared to disavow any affirmative duty to disclose. Rather, the court merely examined what limited disclosures *were* made, in the notice of meeting and at the meeting itself, to determine whether they contained any material misstatements or omissions.[199]

On appeal, the directors maintained that their disclosures to stockholders in connection with the proposed charter amendments were sufficient under any standard of fiduciary disclosure duties, and that those duties did not require them to disclose in advance of the stockholder meeting any more than the minimal information prescribed by statute.[200] "It is the meeting of stockholders," defendants continued, "that is the medium for providing any additional information contemplated by the Corporation Law (*e.g.*, §§ 211, 242 and 251)."[201]

The Delaware Supreme Court could have easily resolved the matter the way the lower court did by reciting the now familiar mantra, that directors owe a fiduciary duty to disclose all material facts when they seek stockholder action, and determining that all material facts had been disclosed. Instead, in apparent disregard of its own recitation of that mantra in *Stroud*,[202] the court repeatedly took the

197. *Stroud*, 16 Del. J. Corp. L. at 1608 ("[The] duty of complete candor cannot be avoided by the directors by a decision not to solicit proxies and to merely comply with the statutory notice provisions of 8 Del. C. §§ 222 and 242.").

198. Id. at 1611.

199. Id. at 1610. This approach may have stemmed from the court's acceptance of the corporation's proprietary view that preserving the confidentiality of its internal information afforded it a competitive advantage. The court explained that "[c]onfidential information . . . is generally not disclosed in proxy materials." Id. at 1610-11. A similar justification for rejecting an affirmative duty of disclosure had previously been articulated by the court of chancery in *Raskin*, 1990-1991 Fed. Secur. L. Rptr. (CCH) ¶ 95,668. See note 185 and accompanying text.

200. Defendants Below-Appellees/Cross-Appellants' Answering Brief on the Appeal and Opening Brief on Their Cross-Appeal at 28-29, *Stroud v. Grace*, 606 A.2d 75 (Del. 1992) (on file with the Author).

201. Id. at 29. It is unclear what "additional information," if any, was *required* to be disclosed at the stockholder meeting under defendants' exposition. In all events, defendants acknowledged—perhaps overbroadly, and certainly without citation to any authority—that "when management undertakes to communicate with stockholders, through proxy statements or otherwise, then usual fiduciary duties of candor attach requiring communications that are sufficiently accurate and full not to be misleading." Id.

202. 552 A.2d at 479. In its subsequent opinion, the court explained that this earlier pronouncement, however emphatic it might have seemed, could not have established a "new substantive principle of law" because, in light of the basis for the earlier dismissal for lack of

trial court to task for adopting "a novel legal framework" and a "novel legal analysis" for evaluating plaintiff's fiduciary disclosure claims.[203] The court then proceeded to articulate a theory that imposed significant, although poorly defined, limits on the reach of the fiduciary duty of disclosure.

After uttering the mantra, the court explained that the duty of disclosure must be evaluated not "in a vacuum" but in the context of statutes requiring and defining the content of notice to stockholders of meetings to act on charter amendments and the like.[204] The court then found that those statutes supply the exclusive definition of the directors' disclosure obligations under state law, "in the absence of a proxy solicitation."[205] It is that circumstance which the court identified as the source of the fiduciary duty of disclosure. "In the absence of that circumstance," the court explained, "questions of disclosure beyond those mandated by statute become less compelling."[206] "Thus," the court explained further, "what we say here is limited to non-public, privately-held corporations."[207]

The court's emphasis on proxy solicitation as the source of the duty of disclosure, and its truncation of that duty in the case of privately-held companies, were both literally incorrect and analytically flawed. The court's limitation was literally incorrect because several of the court's prior opinions invoking and applying a fiduciary disclosure duty did not involve proxy solicitation at all.[208] Indeed, in *Cahall*, which *Stroud* described as the source of a "materiality stan-

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ripeness, it "would have amounted to the issuance of an impermissible advisory opinion." *Stroud*, 606 A.2d at 86.

203. Id. at 84-85. What the court characterized as "novel" in one breath, however, was repeated, in another breath, as "the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action." Id. at 84.

The court's opinion subsequently recharacterized the duty as requiring that the board of directors "disclose fully and fairly all material facts within its control *that would have a significant effect upon a stockholder vote.*" Id. at 85 (emphasis added). If anything was novel, it was the probably unintended adoption in this latter formulation of a reliance/causation requirement, under which the stockholder who is complaining of a breach of disclosure duty must establish that the omitted fact would have had "a significant effect upon a stockholder vote." That is hardly a faithful reading of *TSC Industries*, which the Delaware Supreme Court ostensibly embraces, but which rejected such a stringent reliance/causation requirement. *Stroud*, 606 A.2d at 84-85.

204. Id. at 85 (citing 8 Del. Code Ann. §§ 222(a), 242(b)(1)).

205. Id.

206. Id. at 86.

207. Id.

208. See, for example, *Shell Petroleum*, 606 A.2d at 112 (involving a tender offer by a majority stockholder); *Kirby Lumber*, 413 A.2d at 137 (regarding an information statement used in a short-form merger); *Lynch*, 383 A.2d at 278 (involving a tender offer by a majority stockholder); *Lank*, 224 A.2d at 242 (involving a purchase of steck).

dard [that] has been a mainstay of Delaware law for decades,"[209] stockholders were never even asked to vote or otherwise take action upon the challenged transactions, let alone execute proxies.[210] *Cahall*, moreover, involved a company whose issued stock was no more, and probably less, widely held than the corporation involved in *Stroud*.[211]

Stroud's limitation of the full-blown fiduciary disclosure duty to cases involving proxy solicitation in publicly held companies was analytically flawed as well. The facts on which the court relied in this regard—that large companies depend on proxy solicitation when seeking a stockholder vote and that proxy voters generally do not attend stockholder meetings[212]—do not demonstrate that fiduciary duty does not require disclosure of information beyond statutory notice requirements in contexts not involving public company proxy solicitations. If fiduciary principles require directors of public companies to provide material information to proxy voters in advance of a stockholder meeting, is there any good reason why those same principles would not require directors of less widely held firms to provide material information to proxy voters?[213] Similarly, is there anything in the rationale of those fiduciary principles that would moderate or eliminate the need for directors to provide material information to stockholders in advance of the meeting, even if their proxies are not solicited, as long as they are invited by notice to attend the meeting and vote, and their votes are necessary to the accomplishment of the action proposed to be taken at the meeting?[214] And if stockholder

209. *Stroud*, 606 A.2d at 84.

210. *Cahall*, 114 A. at 234. To be sure, the case did involve a stockholder meeting in which shares were represented by proxy, id. at 238-39, but that meeting related to a transaction—a proposed sale of assets—distinct from the transactions to which the court's holdings regarding disclosure duties in ratification were directed. See notes 272 and 276.

211. The Lewes Fisheries Company involved in the *Cahall* case had only 2,855 outstanding voting shares, *Cahall*, 114 A. at 236, as compared to the over 3,500,000 outstanding shares of Milliken & Company. See Defendants Below-Appellees/Cross-Appellants' Answering Brief on the Appeal and Opening Brief on Their Cross-Appeal at 4, *Stroud v. Grace*, 606 A.2d 75 (Del. 1992) (on file with the Author).

212. *Stroud*, 606 A.2d at 86-87.

213. There is nothing that limits the use of proxies, or their solicitation, to public companies. Indeed, the directors of Milliken & Company had begun to solicit proxies in support of a set of proposed charter and by-law amendments that were subsequently withdrawn. Id. at 79-80.

Before *Stroud* was decided, one scholar had concluded that "[u]nder Delaware's duty of candor standard, the stockholders of both public and close corporations should be subject to the same duty of disclosure." Pease, 14 Del. J. Corp. L. at 479-80 (cited in note 22). *Stroud* was at best imprecise in its rejection of that conclusion.

214. The only conceivable rationale is that stockholders who attend the meeting in person will be able to hear from or question management about the proposal before the vote is taken. As the lower court in *Stroud* recognized, however, that option is a poor substitute for the

ratification of a self-dealing transaction by directors is effective only if the proponents of the transaction disclose all material facts to stockholders in connection with their ratification vote, as is clearly the law,[215] is there any reason to limit or eliminate that disclosure duty in a privately held company and/or where no proxies are solicited in connection with the ratification vote? Certainly the opinion in *Stroud* offered no answer to these questions.[216]

Having concluded, however, that the directors had no duty to disclose anything beyond the minimal information prescribed by statute,[217] the court in *Stroud* then proceeded to blunt the force of that very holding, by (1) suggesting that the absence of proxy solicitation

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opportunity to review and consider written information about a proposal in advance of the meeting. 16 Del. J. Corp. L. at 1611.

215. See Part III.A.

216. The disclosure duty discussion in *Stroud* has another puzzling aspect. That entire discussion occurred in the context of detormining whether the stockholders of Milliken & Company effectively ratified the challenged charter amendments and "place[d] the burden of proof on the challenger." *Stroud*, 606 A.2d at 83. See also id. at 90 (after finding "no breach of any fiduciary duty in connection with the shareholder voto at the 1989 annual meeting," holding that the stockholders "effectively ratified the board's action" and "shift[ed] the burden of proof to the [plaintiffs] to prove that the transaction was unfair"). One might fairly ask why it was appropriate to evaluate stockholder ratification initially. If the directors and controlling stockholders had no conflict of interest regarding the proposed amendments—and the court specifically found that no entrenchment motive existed, id. at 83—those proponents of the transaction had no need for a ratification vote to shift the burden of proof, and there was no cause to examine the directors' actions under any unfavorable burden of proof. See, for example, *Cede & Co.*, 634 A.2d at 361. Alternatively, if the controlling stockholders and directors were to have been deemed personally intorested in the amendments—not a frivolous claim, since the proposed 75% vote requirement te issue stock effectively prevented the board from making any attempt to dilute the holdings of the controlling stockholders against their will—it seems unlikely at best that the stockholder vote *could* have resulted in a shift in the burden of proof, for two related reasons. First, the votes of self-interested steckholders—such as the Milliken majority stockholder group, as presumed in this discussion—are ordinarily not counted toward effective ratification. *Fliegler v. Lawrence*, 361 A.2d 218, 221 (Del. 1976); Drexler, *Delaware Corporation Law* ¶ 15.05[4] at 15-24 (cited in note 30); *ALI Principles* §§ 1.16, 5.10 (cited in note 32). Second, it is highly unlikely that the amendments were approved by a "majority of the minority" ratification vote, which arguably could have shifted the burden of proof. See *Weinberger*, 457 A.2d at 703. If the proponents owned over 56% of the outstanding shares (their precise percentage of ownership is not a matter of public record), less than a majority of the minority shares would have voted for the challenged amendments, since only 78% of the outstanding shares were voted in favor of the amendments. *Stroud*, 606 A.2d at 80-81.

Therefore, the only analytically supportable explanation for the court's extended inquiry into the fiduciary duty of disclosure is an inplicit holding that if a material fact had not been disclosed to the stockholders, the charter amendments could have been invalidated, notwithstanding any presumption of validity attaching to the board's action in approving their submission to a stockholder vote, simply and solely because of the breach of the disclosure duty.

The court's 1996 decision in *Williams v. Geier* reinforces this view. After affirming that a disinterested board's recommendation of a "tenure voting" recapitalization plan was "protected by the business judgment rule," 671 A.2d at 1378, the court, closely tracking its analysis in *Stroud*, nonetheless went on to examine whether "all material facts relevant to the transaction were disclosed." *Geier*, 671 A.2d at 1378, 1379.

217. *Stroud*, 606 A.2d at 87.

"does not lessen a board's fiduciary duty of disclosure" but results in "[t]he emphasis of such disclosure . . . [being] shifted to that which occurred at the annual meeting,"[218] and (2) proceeding to consider separately whether the directors "violated their duty of disclosure by their alleged misstatements and omissions at the annual meeting."[219] Does this mean that the difference, as concerns the fiduciary duty of disclosure, between public company proxy solicitations and private company stockholder meetings without proxy solicitation is merely a question of timing? Does the fiduciary duty of disclosure require the same disclosures in the latter case, but only at the time of the stockholder meeting and not in conjunction with the statutory written notice of the meeting? Such questions are analyzed in Part V, along with the suggestion that *Stroud* reached the correct result but should have been decided on the entirely different basis that no fiduciary disclosure duty should or could have attached under the circumstances where the minority stockholders were powerless to adopt or stop the proposed charter amendments and had no appraisal election to make and no state law basis for enjoining implementation of the amendments.[220]

2. *Zirn v. VLI Corp.*

Although it pointedly rejected any fiduciary or statutory obligation of directors to disclose material facts in or with a notice of stockholders meeting where proxies are not solicited, *Stroud* re-endorsed the notion that directors could be held liable in damages for having issued a public statement to stockholders that misrepresented or omitted a material fact, even in connection with a transaction in

218. Id. That "shift" of disclosure to the stockholder meeting is puzzling, as a matter of timing, in view of the court's treatment elsewhere in the opinion of the handling of material but confidential information. According to that treatment, the board has a burden of proving (1) "complete disclosure of material facts," and (2) if such facts include confidential information, that the stockholders have been "given notice and opportunity . . . to execute a reasonable confidentiality agreement" and thereby gain access to information. Id. at 89. How all of this is supposed to happen if the disclosure obligation does not require that information be provided until the stockholder meeting is unclear. Perhaps the directors, anticipating a duty to disclose confidential information at the meeting itself, must alert stockholders to that possibility before the meeting in sufficient time to permit them to sign confidentiality agreements and be given the confidential information at the meeting. It is also unclear from *Stroud*, however, whether stockholders who decline or fail to sign such confidentiality agreements may or must be excluded from the stockholder meeting so that the material confidential information can be presented in a sort of executive session, to the stockholders who do execute such agreements.

219. Id. at 87-88.

220. See note 360 (discussing *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991)).

which they had no personal interest. The validity of this notion was squarely presented in *Zirn v. VLI Corp.*[221]

In *Zirn*, the individual defendants had been directors of VLI Corporation, which had been acquired in a tender offer in December 1987 in which 94.8% of the stock was acquired, and then a short-form merger in January 1988.[222] The directors were charged with having failed to disclose material facts not in a proxy solicitation but in the Schedule 14D-9 filed on behalf of the directors in response to the first-step tender offer.[223] In defense, the directors urged that the Schedule 14D-9 had disclosed all material facts and that VLI's certificate of incorporation eliminated their monetary liability for any breach of fiduciary duty occasioned by any failure to disclose material facts.[224] Strikingly, the defendants never questioned the legal proposition that, despite the absence of self-interest, bad faith, or lack of care,[225] the directors could, but for the exculpatory charter provision, be found personally liable for damages for failure to disclose a material fact in the Schedule 14D-9.[226] Perhaps as a result, neither did the Delaware Supreme Court. The court's opinion found the exculpatory charter provision inapplicable[227] and remanded the damages case against the directors for a determination of materiality of the undisclosed information at issue.[228]

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221. 621 A.2d 773 (Del. 1993).

222. Id. at 777.

223. Id. at 778.

224. Id. at 779, 783.

225. Id. at 779 (holding irrelevant "the sincerity of [the directors'] subjective beliefs" and noting that materiality, not motive, is dispositive: "a material omission is not rendered immaterial simply because the party making the omission honestly believes it insignificant").

226. See Joint Answering Brief of Defendants Below-Appellees, *Zirn v. VLI Corp.* 621 A.2d 773 (Del. 1993) (on file with the Author).

227. After concluding in broad abstraction that a director's duty "to disclose to shareholders all material facts hearing upon a merger vote arises under the duties of care and loyalty," *Zirn*, 621 A.2d at 778, the court concluded—despite the absence of any evidence of self-dealing on the part of the VLI directors—that any breach of fiduciary disclosure duty necessarily arose under the duty of loyalty, and the exculpatory charter provision therefore could not, under the authorizing statute (8 Del. Code Ann. § 102(b)(7)), permissibly preclude liability for damages on account of such a breach. Id. at 783.

This aspect of the court's opinion was questionable, and was in fact pointedly questioned. Bradford D. Bimson, Comment, Zirn v. VLI Corp.*: The Far-Reaching Implications of Loquacity*, 19 Del. J. Corp. L. 1067, 1116 (1994). In any event, the Delaware Supreme Court's decision in *Arnold* dispels any notion that a failure to disclose necessarily precludes director reliance upon an exculpatory charter provision adopted pursuant to statute.

228. *Zirn*, 621 A.2d at 780. On remand, the court of chancery found that the undisclosed information at issue was not material, under applicable legal standards. *Zirn v. VLI Corp.*, 1995 Del. Chanc. LEXIS 74, *12-14 (June 12, 1995). The threat of damages liability may not have been a great concern to the individual directors, who may well have had a right to require the continuing corporation to indemnify them with respect to any money damages that might have been assessed against them. See 8 Del. Code Ann. § 145(a), (f); Drexler, *Delaware*

3. *Arnold v. Society for Savings Bancorp, Inc.*

The underlying issue of whether disinterested directors can be held personally liable in damages for a breach of the fiduciary duty of disclosure was presented yet again in *Arnold v. Society for Savings Bancorp, Inc.*[229] In *Arnold*, the plaintiff brought a class action on behalf of stockholders of Society for Savings Bancorp, Inc. ("Society") whose shares were converted, in a merger with an acquisition subsidiary of Bank of Boston Corporation, into shares of Bank of Boston common stock. After the transaction was consummated following denial of a motion for a preliminary injunction, plaintiff sought damages, on a variety of theories, from the directors of Society who approved the merger but were not affiliated with Bank of Boston and had no other distinct personal interest in the merger.

The plaintiff's theory that elicited the greatest attention was the claim that the directors had breached a fiduciary duty of disclosure by omitting or misrepresenting material facts in the proxy statement submitted to stockholders in connection with the merger. Judgment for defendants, premised on a finding that no material facts had been omitted in the proxy statement, was appealed and argument was held in the Delaware Supreme Court on April 5, 1994. In the ensuing months, however, the composition of the court changed, with Chief Justice E. Norman Veasey replacing Justice Andrew G.T. Moore on the panel, and the court resolved to determine and rehear the case *en banc*. Perhaps as a result of that change, the court requested supplemental briefing on a number of issues and, at last, asked counsel to explain the nature of the fiduciary duty of disclosure that had been taken for granted in *Zirn* and, until that point, in *Arnold* as well.[230] In particular, the court asked for supplemental briefing on the following question: "Is the duty of disclosure a separate, free-standing fiduciary duty, or does it arise under, and always subsumed within, the duty of care and/or duty of loyalty?"[231]

In understandably truncated briefing,[232] counsel ably highlighted their competing views. Plaintiff's counsel emphasized the broad language of *Lynch*,[233] the separate identification of a fiduciary

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Corporation Law ¶ 16.02[2] at 16-6 (cited in note 30); Balotti and Finkelstein, *Delaware Law of Corporations* § 4.16 at 4-348 (cited in note 30).

229. 650 A.2d 1270 (Del. 1994).

230. Letter from Cathy L. Howard, Assistant Clerk, te counsel in *Arnold v. Society for Savings Bancorp, Inc.* (Aug. 5, 1994) (on file with the Author).

231. Id.

232. Counsel were allowed just 15 pages to argue four separate issues. Id.

233. See text accompanying note 39.

disclosure duty in *Van Gorkom*,[234] and cases granting preliminary injunctions based on nondisclosure despite findings of inadvertence and good faith on the part of disinterested directors.[235] Defendants' counsel noted the foundation of *Lynch* in the duty of loyalty[236] and stressed, without citing any authority, that to impose monetary liability on directors for good faith disclosure errors not resulting from negligence would contravene what they characterized as the "generally respected proposition" that directors cannot be held personally responsible for good faith judgments made with due care.[237]

Unfortunately, the court did not use the opportunity to clarify the fundamental character of the fiduciary duty of disclosure. The court merely quoted *Lynch*'s "complete candor" language,[238] noted blandly that "[a] number of subsequent decisions have recognized the existence of fiduciary disclosure obligations,"[239] and cited *Stroud* for the proposition that the disclosure "obligation attaches to proxy statements and any other disclosures in contemplation of stockholder action."[240] The court concluded that the proxy statement contained an omission of material fact but that the directors were immune from monetary damages liability due to the exculpatory provision in Society's certificate of incorporation.[241]

The implications of *Arnold* regarding the basic nature of the fiduciary duty of disclosure are unclear. One could contend that the court would not have reached the issues surrounding the exculpatory charter provision unless it had concluded that the fiduciary disclosure obligation carried with it the possibility of monetary damages even for what the court found was an innocent, unselfish breach of the obliga-

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234. See text accompanying notes 160-62.

235. See cases cited in note 152. Opening Supplemental Brief of Plaintiff-Below/Appellant at 3-8, *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994) (on file with the Author).

236. See note 117.

237. Supplemental Brief of Defendants/Appellees at 4, *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994) (on file with the Author).

238. *Arnold*, 650 A.2d at 1276.

239. Id. at 1276-77 (citing, in addition to *Weinberger, Van Gorkom, Stroud* and *Zirn, Tri-Star*, 634 A.2d at 331-32, 334; *Cede & Co.*, 634 A.2d at 373; *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 846 (Del. 1987); *Rosenblatt*, 493 A.2d at 936, 944-45).

240. Id. at 1277.

241. Id. at 1286-88. The court read section 102(b)(7) of the Delaware General Corporation Law as unambiguously permitting elimination by charter provision of monetary damages liability for all breaches of fiduciary duty, including any fiduciary duty of disclosure, except for breaches of duty identified in the statutory exceptions—"(i) . . . any breach of the director's duty of loyalty te the corporation or its stockholders; [and] (ii) . . . acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law . . . "—which the court found inapplicable. See 8 Del. Code Ann. § 102(b)(7).

tion.[242] Alternatively, because it exonerated the directors based on the exculpatory charter provision, the opinion may have merely assumed, without deciding, that such damages liability could exist in the absence of an exculpatory provision.

The *Arnold* opinion also begged another important question about the scope of the fiduciary duty of disclosure—whether the duty is merely a rule against avoiding false or misleading statements or omissions, or whether it imposes an affirmative duty to disclose facts material to a pending stockholder decision. Clearly, the court found the undisclosed fact at issue, a pre-merger bid for a key division, to have been material solely because the directors had made partial disclosure about the related pre-merger efforts to sell the company which became materially misleading by omission of the undisclosed bid.[243] Just as clearly, the court disavowed any decision regarding whether the undisclosed fact "was material as a matter of law,"[244] and to what extent, if any, the fiduciary duty of disclosure extends beyond a requirement of avoiding false or misleading statements to an affirmative duty to disclose.[245]

Thus, the *Arnold* opinion still leaves to commentators the task of defining the full scope and content of the fiduciary duty of disclosure.[246] With the history of the Delaware case law on that subject now behind us, we turn next to how general concepts of fiduciary obligation can assist in that task.

V. THE APPLICATION OF FIDUCIARY THEORY

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242. *Arnold*, 650 A.2d at 1288 n.36 ("We agree with defendants that, on this record, the single disclosure violation which we have found was consistent only with a good faith omission.").

243. Id. at 1277-80.

244. Id. at 1282.

245. To be sure, the court's allowance of the possibility that the bid might have been material, id. at 1277, indicates a receptivity to the argument tbat some facts are material and must be disclosed, as a matter of fiduciary duty, without regard to the content or existence of any related disclosure.

246. Indeed, it was only on remand in the *Arnold* case that the courts first considered head-on whether the directors' duty of disclosure inheres in and derives to any extent from the statutes requiring notice of meetings to consider fundamental transactions. On remand, the Chancery Court ruled that plaintiff's case arose under a "separate fiduciary duty of disclosure," and that the merger statute "does not require the directors of a corporation to inform the stockholders of all material facts prior to the vote on the merger." *Arnold v. Society for Savings Bancorp, Inc.*, 1995 Fed. Secur. L. Rptr. (CCH) ¶ 98,827, at 92,989 (Del. Chanc. June 15, 1995), aff'd, 678 A.2d 533 (Del. 1996). The Delaware Supreme Court has affirmed that ruling, holding that "[t]he duty of disclosure is a judicially imposed fiduciary duty which applies as a corollary to the statutory requirements." *Arnold*, 678 A.2d at 537. That ruling flows logically from the narrow reading of the notice statutes in *Stroud*, 606 A.2d at 85.

A. Conceptual Introduction

Defining the proper scope and content of the director's fiduciary duty of disclosure requires more than the expression by an individual judge of a personal preference or notion about the matter. The legitimacy of a legal doctrine under which judges may, in the absence of any statute, sanction private behavior through injunctive relief or an award of damages depends upon a rooting in what is perceived by the relevant community as traditional principle.[247] If a court is to require a corporate director to pay damages or to enjoin or rescind a corporate transaction because of a failure to disclose material information to stockholders, it may exercise such coercive power, in the absence of statute, only by invocation of such traditional principle.

What, then, are the traditional principles of the law of fiduciary duty that define the obligation of a corporate director to disclose material information to stockholders? To pose this question is much easier than to answer it. As "the legal system's attempt to recognize the more blatant abuses of the trust we place in each other,"[248] the law of fiduciaries has been described as "the most human area of the legal system, and as such the most undefinable."[249] Attempts to identify the essential general principles of fiduciary relationships are still relatively rare.[250] Even a fairly recent attempt laments that "the precise nature of the fiduciary relationship remains a source of confusion and dispute," and that "[l]egal theorists and practitioners have failed to define precisely when such a relationship exists, exactly what

247. See, for example, Guido Calabresi, *A Common Law for the Age of Statutes* 97 (Harvard U., 1982) ("Each judicial decision, at its best, is meant to represent a reasoned attempt to adapt a past set of decisions te a current problem."); Benjamin N. Cardozo, *The Nature of the Judicial Process* 141 (Yale U., 1921); Charles D. Breitel, *The Lawmakers*, 65 Colum. L. Rev. 749, 773 (1965).

248. Shepherd, *Law of Fiduciaries* at v (cited in note 49).

249. Id.

250. See, for example, id.; P.D. Finn, *Fiduciary Obligations* (Carswell, 1977); Tamar Frankel, *Fiduciary Relationships in the United States Today*, in Donovan W. M. Waters, ed., *Equity, Fiduciaries and Trusts* 173 (Carswell, 1993); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 Yale L. J. 625 (1995); Robert Cooter and Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. Rev. 1045 (1991); Robert Flannigan, *The Fiduciary Obligation*, 9 Oxford J. Legal Stud. 285 (1989); P.D. Finn, *The Fiduciary Principle*, in T.G. Youdan, ed., *Equity, Fiduciaries and Trusts* 1 (Carswell, 1989); Deborah DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 Duke L. J. 879; Hetherington, 22 Wake Forest L. Rev. at 9 (cited in note 37); Tamar Frankel, *Fiduciary Law*, 71 Cal. L. Rev. 795 (1983); Ernest J. Weinrib, *The Fiduciary Obligation*, 25 U. Toronto L. J. 1 (1975); L. S. Sealy, *Some Principles of Fiduciary Obligation*, 1963 Cambridge L. J. 119; L. S. Sealy, *Fiduciary Relationships*, 1962 Cambridge L. J. 69; Austin W. Scott, *The Fiduciary Principle*, 37 Cal. L. Rev. 539 (1949).

constitutes a violation of this relationship, and the legal consequences generated by such a violation."[251]

Nonetheless, and acknowledging that the exercise necessarily lacks scientific precision,[252] defining the director's duty of disclosure can proceed by first identifying the basic features of the director/stockholder relationship, and then examining what fiduciary responsibilities traditionally attach by reason of those basic features.

1. The Structure of the Director/Stockholder Relationship

The principal feature of the director/stockholder relationship is the allocation of managerial power. Directors are endowed by law with the power to exercise authority over the management of resources that are understood to belong, in terms of residual ownership interest, to others, namely the stockholders.[253] That managerial responsibility is most commonly discussed in relation to business deci-

251. Cooter and Freedman, 66 N.Y.U. L. Rev. at 1045-46 (cited in note 250). See also Flannigan, 9 Oxford J. Legal Stud. at 286 (cited in note 250) ("Judicial and academic conclusions, however, have been tentative. There is much that remains obscure."). See also Clark, *Agency Costs* in Pratt and Zeckhauser, eds., *Principals and Agents* at 71 (cited in note 37) ("Perhaps because the subject matter is so sprawling and elusive, there has been little legal analysis of the fiduciary concept that is simultaneously general, sustained, and astute.").

252. It cannot be accepted that Darwinian market forces inexorably lead the courts to articulate comprehensive fiduciary disclosure principles that minimize agency costs and thereby hest serve the needs and expectations of the parties te commercial relationships. Clark, *Agency Costs* in Pratt and Zeckhauser, eds., *Principals and Agents* at 63-64 (cited in note 37) (acknowledging that "the more elementary features of the corporate form . . . result from (fairly slow, crude) processes of legal evolution that favor rules that reduce transaction costs," but questioning whether market forces meaningfully shape the finer issues of fiduciary doctrine). The normative value of such a market-oriented view is at best questionable, where the empirical effects of nuances of state fiduciary law rules on stock prices, firms' cost of capital, and incorporation decisions are so very difficult to isolate. The baffling intricacy of the problems posed by this approach is painstakingly and, ultimately, frustratingly explored in Elliott J. Weiss and Lawrence J. White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 Cal. L. Rev. 551 (1987). They conclude that "investors' well-documented failure to react to announcements of reincorporation decisions, like their failure to react to the judicial decisions we studied, may well reflect little more than their judgments about the indeterminacy of corporate law." Id. at 602. They urge us, in evaluating corporate law issues, to explore instead "the normative, historical, and institutional facters involved." Id. at 603.

253. The directors' power to manage the corporation's assets is explicit under many corporate statutes. See, for example, 8 Del. Code Ann. § 141(a); Model Bus. Corp. Act Ann. § 8.01(b). Less explicit under statuto, but just as clear as a matter of law, is the stockholders' residual interest in the assets of the corporation. Hetherington, 22 Wake Forest L. Rev. at 15 (cited in note 37). It is thus commonplace that directors serve as fiduciaries, accountable to the stockholders, in respect of the management of the corporation's assets. Mitchell, 43 Duke L. J. at 430 (cited in note 99); Flannigan, 9 Oxford J. Legal Stud. at 317 (cited in note 250); DeMott, 1988 Duke L. J. at 908 (citod in noto 250); Sealy, 1963 Cambridge L. J. at 74-75 (cited in noto 250).

sions as conventionally defined: building a factory, issuing stock, or approving a fundamental corporate change such as a merger.[254]

Directors' managerial responsibilities, however, also include an advisory function. Directors must in certain circumstances make recommendations to stockholders regarding proposed actions that fundamentally affect the interests of the stockholders, such as mergers,[255] charter amendments,[256] sales of all or substantially all of the corporation's assets,[257] dissolution,[258] or tender offers to acquire stock of the corporation.[259] The allocation to directors of that advisory responsibility has an obvious rationale. As the ultimate repository and source of information about the corporation and its affairs, directors are most efficiently situated to provide information to stockholders when the stockholders are called upon to act on mergers, tender offers, and the like.[260]

2. Concomitant Fiduciary Principles

Managerial power and influence over another's assets inevitably involve potential for abuse by the manager. Fiduciary duty is the brake applied by the law to the exercise of such power or influence.[261] The law of fiduciary duty imposes upon persons—such as corporate directors—who exercise such power or influence a responsibility to manage the resources of the common enterprise so as to maximize the profit derivable from those resources.[262]

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254. See, for example, *ALI Principles* § 4.01(e) cmt. b at 173-74 (cited in note 32).

255. See, for example, 8 Del. Code Ann. § 251(c); Model Bus. Corp. Act Ann. § 11.03.

256. See, for example, 8 Del. Code Ann. § 242(b); Model Bus. Corp. Act Ann. § 10.03(b).

257. See, for example, 8 Del. Code Ann. § 271(a); Model Bus. Corp. Act Ann. § 12.02(b).

258. See, for example, 8 Del. Code Ann. § 275(b); Model Bus. Corp. Act Ann. § 14.02(b).

259. 17 C.F.R. § 240.14e-2.

260. In corporate decision-making, isolated stockholders cannot efficiently gather the pertinent information, so "some sort of collective information-generating agency is necessary. In a firm, the managers serve this function, and consequently it is unlikely that voters would think themselves able to decide with greater insight than the managers do. No wonder voters delegate extensively to managers and almost always endorse their decisions." Easterbrook and Fischel, *Economic Structure* at 66-67 (cited in note 3). See also Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461, 467-68 (1992) (citing Kenneth J. Arrow, *The Limits of Organization* 68-69 (Norton, 1974)).

261. Finn, *Fidueiary Principle* at 3 (cited in note 250).

262. As to corporate directers, see *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N.W. 668, 684 (Mich. 1919); *ALI Principles* § 2.01(a) at 70 (cited in note 32); Hetherington, 22 Wake Forest L. Rev. at 15 (cited in note 37). One cannot articulate the widely accepted view that directors' overriding responsibility is to maximize steckholder value, however, without acknowledging the depth of the debate on the subject. See, for example, Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 Tex. L. Rev. 579 (1992); David Millon, *Redefining Corporate Law*, 24 Ind. L. Rev. 223 (1991).

Such fiduciary responsibility, however, varies in its application. It is a brake applied most forcefully where those who exercise managerial powers do so in ways in which their own personal interests are served.[263] The moral disapproval and stringent sanctions meted out by the courts in this context are fitting. In a setting in which the directors' potential for gain from abuse of the relationship is great, the rules and tone of fiduciary law contribute to the confidence of stockholders that their investment will be managed faithfully. Thereby, fiduciary law helps preserve the socially efficient relationship of specialization that exists when directors are entrusted with authority to manage the resources of others.[264] By punishing directors who abuse their position by diverting corporate assets to themselves, deterring such behavior as well as compensating its victims, the fiduciary duty of loyalty reduces the risk associated with investment in corporate equity and the costs of monitoring the behavior of corporate managers and thereby reduces the cost of equity capital.[265]

In the absence of self-dealing, however, the brake of fiduciary duty upon managerial action is less forceful. True, the law insists that directors and officers exercise reasonable care in managing the affairs of the corporation.[266] Judicial sanctions for disinterested but harmful decisions are limited, however, to cases of "gross negligence" or irrationality suggesting bad faith or recklessness.[267] The fiduciary duty of care, as thus refined by the "business judgment rule,"[268] reflects a balance of regulation that reduces the costs of monitoring the behavior of corporate managers, avoids undue discouragement of

263. See, for example, Langbein, 105 Yale L. J. at 655-56 (cited in note 250).

264. Cooter and Freedman, 66 N.Y.U. L. Rev. at 1074 (cited in note 250); Hetherington, 22 Wake Forest L. Rev. at 11 (cited in note 37); Alison Grey Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. Rev. 738, 740 (1978); Weinrib, 25 U. Toronto L. J. at 15 (cited in note 250).

265. Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. Chi. L. Rev. 1047, 1090 (1995); Cooter and Freedman, 66 N.Y.U. L. Rev. at 1052-56, 1074 (cited in note 250); Frankel, 71 Cal. L. Rev. at 831-32 (cited in note 250); Anderson, 25 UCLA L. Rev. at 740 (cited in note 264).

266. See, for example, *Briggs v. Spaulding*, 141 U.S. 132, 147 (1891); *Cede & Co.*, 634 A.2d at 367-68; Model Bus. Corp. Act Ann. § 8.30(a); *ALI Principles* § 4.01(a) (cited in note 32).

267. See, for example, *Van Gorkom*, 488 A.2d at 873; Dooley, 47 Bus. Law. at 471-72 (cited in note 260); Joseph Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 Yale L. J. 1078, 1099-1100 (1968).

268. See, for example, *Joy v. North*, 692 F.2d 880, 885-86 (2d Cir. 1982); *Cede & Co.*, 634 A.2d at 360-61.

entrepreneurial risk-taking, and thereby enhances stockholder wealth.[269]

3. Four Paradigm Contexts for Articulating the Director's Fiduciary Duty of Disclosure

Ordinarily, directors are not called upon by state law to communicate with stockholders in regard to exercising their managerial powers, inasmuch as stockholder consent to corporate action is generally not required.[270] There are occasions, however, when directors do communicate with stockholders, either voluntarily or out of regulatory obligation. Those occasions can be summarized in the following four paradigm contexts: (1) An effort by a director to obtain and invoke stockholder consent to a transaction between the director and the corporation; (2) Acquisition by a director of stock from an outside, public stockholder; (3) Recommendation by directors of stockholder action on a transaction in which the directors have no personal interest; and (4) Public statements by the directors not directed specifically to stockholders but potentially influencing stockholder investment decisions.

As will be seen, the fiduciary considerations applicable to these four paradigm contexts vary considerably. With the fiduciary principles previously discussed in mind, it is necessary to analyze each situation individually to determine whether a fiduciary duty of disclosure exists, who owes the duty, what disclosure such a duty requires, and what remedies are appropriate for a breach of the duty.

B. Ratification Disclosure and the Duty of Loyalty

As previously noted,[271] the courts reserve the harshest moral indignation for the actions of self-interested fiduciaries who use their position of authority to obtain benefits at the expense of those they are charged with protecting.[272] Corporation law, of course, does not

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269. *Joy*, 692 F.2d at 886; Easterbrook and Fischel, *Economic Structure* at 94-100 (cited in note 3); Cooter and Freedman, 66 N.Y.U. L. Rev. at 1075 (cited in note 250).

270. This proposition is a corollary of the fundamental division of corporate managerial power as between directors and stockholders. See note 253.

271. See note 37 and text accompanying note 263.

272. See, for example, *Weinberger*, 457 A.2d at 710; *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939). In *Cahall v. Lofland*, 114 A. 224 (Del. Chanc. 1921), the president/director, while acting as an agent for a purchaser of corporate assets, failed to inform stockholders, in connection with their vote to approve the asset sale, that the buyer had already contracted to resell the assets at a substantial profit. The court observed:

forbid self-dealing by directors. Frequently by statute, but by case law precedent as well, it tolerates self-dealing accompanied by assurances of fairness.[273] Where that assurance derives from the consent of the stockholders, however, fiduciary law is unsurprisingly demanding of proof that the consent is fully informed and otherwise fairly procured.[274] Because reliance on such consent is intended to deflect what would otherwise be the most severe judicial scrutiny, the fiduciary duty of disclosure in this context takes on its most stringent form, in what can be labeled a ratification duty of disclosure. The following questions and answers define more fully this venerable and robust subspecies of the director's fiduciary duty of disclosure.

1. Upon Whom Does the Fiduciary Disclosure Duty Rest?

The duty of disclosure rests upon the directors who invoke stockholder consent to a transaction in which their interest is in conflict with the interests of stockholders generally.[275] That duty may likewise rest, at least indirectly, upon those who actively participate

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> From this one is reluctantly driven to the conclusion that such an advantage was taken of the ignorance of the stockholders of facts above referred to, which were concealed from them by one whose duty it was to inform them of these facts, that they did not then have before them data from which to make an intolligent choice, or protect themselves from the effect of the duplicity of their trusted representative.

Id. at 239. See also *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928); Hetherington, 22 Wake Forest L. Rev. at 10-11 (cited in note 37); Frankel, 71 Cal. L. Rev. at 829-32 (cited in note 250).

273. Model Bus. Corp. Act Ann. § 8.61(b); 8 Del. Code Ann. § 144; *Oberly*, 592 A.2d at 467; *Merritt v. Colonial Foods, Inc.*, 505 A.2d 757, 763-64 (Del. Chanc. 1986); Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 Bus. Law. 35, 36-38 (1966).

274. See notes 95-97, 108 and accompanying text.

275. The level of director interest in a transaction sufficient to trigger application of the traditional duty of loyalty, and concomitant duty of disclosure, is not precisely definable. The Delaware Supreme Court has identified defensive actions tending to perpetuate directors' control as giving rise to an "omnipresent specter" of director self-interest. The drafters of the Model Business Corporation Act, however, have excluded defensive conduct not involving a direct personal financial benefit to the director from the definition of director conflict of interest transactions. Compare *Unocal*, 493 A.2d at 954, with Model Bus. Corp. Act Ann., Official Comment to § 8.60 ("Director's Conflicting Interest Transaction"). The recent opinion in *Williams v. Geier* somewhat clarifies Delaware law on this point, holding that the enhanced judicial scrutiny required by *Unocal* applies "only where a board unilaterally (i.e., without stockholder approval) adopts defensive measures in reaction to a perceived threat." *Williams*, 671 A.2d at 1376. Accordingly, where directors do *not* adopt defensive measures unilaterally—as where director action is limited to recommending defensive charter provisions for approval by stockholders—Delaware law appears to reject the claim that the directors are acting out of self-interest and must therefore bear some burden, as prescribed by *Unocal*, of presenting evidence of the reasonableness of their investigation of and response to a threat to corporate interests. Yet in *Santa Fe* the court found that stockholder approval of a merger did not constitute approval of unilateral director actions taken to promote the merger, and did not relieve directers of their burden under *Unocal* to establish the reasonableness of their perception of a threat to corporate policy and the reasonableness of their unilateral actions in relation to that threat. *Santa Fe*, 669 A.2d at 68.

with such directors in the transaction.[276] The duty of disclosure, as it exists in this self-dealing context, does not rest upon other directors who have no personal interest in the transaction at issue and do not rely upon stockholder consent to avoid liability in connection with the transaction.[277]

2. Is the Duty One of Affirmative Disclosure, or Merely Avoidance of Misrepresentation or Misleading Incompleteness?

Since the ratification duty of disclosure by definition exists only where self-dealing managers initiate communication with stockholders in order to obtain their consent to self-dealing conduct, it makes little practical difference whether the disclosure duty is defined as an affirmative duty to speak or merely a duty to avoid misleading incompleteness once some disclosure is made.[278] The ratification context presupposes that self-interested directors provide to stockholders at least *some* description of the transaction as a means of establishing effective stockholder consent. By virtue of a duty of completeness alone, then, all material facts relating to that description must be disclosed.[279] Moreover, stockholder consent can-

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276. See *Roberts v. General Instrument Corp.*, 1990 Fed. Secur. L. Rptr. (CCH) ¶ 95,465, at 97,405-07 (Del. Chanc. Aug. 13, 1990) (evaluating sufficiency of disclosure in tender offer by buyout firm affiliated with management); *In re Shoe-Town, Inc. Stockholders Litigation*, 1990 Del. Chanc. LEXIS 14, *27 (Feb. 12, 1990); *In re Fort Howard Corp. Shareholders Litigation*, 1988 Del. Chanc. LEXIS 110, *45-46 (Aug. 8, 1988); *Cahall*, 114 A. at 237 (finding a buyer of corporate assets liable for aiding and abetting president/director's concealment of material fact in securing stockholder approval of asset sale).

277. See *Shoe-Town*, 1990 Del. Chanc. LEXIS 14 at *26. A disinterested director may be charged with breach of a fiduciary duty if she approves, with the requisite lack of care, a transaction between the corporation and another director. Although not personally interested in the transaction, such a director could invoke steckholder ratification as a defense, and would have to establish the same full disclosure, as a predicate te effectiveness of the ratification, that the interested director would have to establish to defend the transaction.

278. See Restatement (Second) of Torts § 551(2)(b) & cmt. g (1977) (discussing the common law disclosure duty of completeness); *Issen v. GSC Enterprises, Inc.*, 538 F. Supp. 745, 751 (N.D. Ill. 1982): "The common law of torts also provides that when a party makes a materially incomplete disclosure, that party has the duty to disclose whatever additional material information is necessary to prevent the partial disclosure from misleading the recipient." Id. at 751. See also *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1313 (5th Cir. 1977). Compare *In re General Motors Class E Buyout Securities Litigation*, 694 F. Supp. 1119, 1129 (D. Del. 1988) (criticizing *Issen* but acknowledging a duty of completeness under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5).

279. See, for example, *Arnold*, 650 A.2d at 1280-81 (applying a duty of completeness as part of fiduciary disclosure duty in recommending a merger); *Lynch*, 383 A.2d at 281. At least one court has suggested, however, that the fiduciary duty of disclosure does not require self-dealing managers to disclose their "consideration of the price at which [they] will buy or sell and how [they] would finance a purchase or invest the proceeds of a sale." *Kahn v. Tremont Corp.*, 196 Del. Chanc. LEXIS 40, *55 (Mar. 21, 1996, revised Mar. 27, 1996).

not be considered effective unless the nature of the directors' conflict of interest is explained.[280] Thus, to the extent that the transaction and its effect on the corporation can be described, consistent with a duty of completeness, without revealing that conflicting interest, it could be said that the duty to disclose that interest is affirmative in nature, and not merely a duty of completeness.[281]

It should not be inferred, however, that directors have an absolute, affirmative duty to disclose self-dealing to stockholders. A self-dealing transaction could be valid even if it is never revealed to stockholders, if it can be shown to have been intrinsically fair.[282] The absence of any absolute state law duty to disclose self-dealing points out the importance, in the public company context, of federal law requiring disclosure of management conflicts of interest.[283] Without such affirmative disclosure requirements, the widely acclaimed benefits of state fiduciary law restricting self-dealing could be substantially

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280. See, for example, 8 Del. Code Ann. § 144(a)(1), (2); *ALI Principles* § 5.02(a)(1) (cited in note 32).

281. The directors' conflict frequently is revealed in a complete description of the transaction, as, for example, where stock or a stock option is issued to directors individually. See, for example, *Michelson*, 407 A.2d at 211; *Cahall*, 114 A. at 224. In that setting, it is difficult to imagine that the transaction could be described completely without identifying the party to whom the stock or option is being issued. Where the directors' conflict is more attenuated, however—as in the case where steck is issued to a corporation of which the directors are officers or significant stockholders—the transaction (including the identity of stock purchaser) could perhaps be described, consistent with a duty of completeness, without revealing the directors' conflict. Such completeness, however, would not satisfy the demands of fiduciary law.

282. See *Ohio Drill & Tool Co. v. Johnson*, 498 F.2d 186, 195 (6th Cir. 1974) ("[W]hen a cloak of secrecy is raised concealing the self-dealing transaction, the directors must prove that nothing is amiss behind the shield."); *Shlensky v. South Parkway Building Corp.*, 19 Ill. 2d 268, 166 N.E.2d 793, 812 (Ill. 1960); Balotti and Finkelstein, 1 *Delaware Law of Corporations* § 4.9 at 4-225 n.745 (cited in note 30): "[I]f the price is fair, inadequate disclosure may not necessarily establish an independent basis for invalidating an interested transaction. As long as the transaction is fair within the meaning of *Weinberger*, the transaction should be upheld." Id. at 4-225 n.745. Compare *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wash. 2d 375, 391 P.2d 979, 984 (1964) (nondisclosure of self-dealing may per se render the transaction voidable); *ALI Principles* § 5.02(a)(1) at 241-42, n.6 (cited in note 32); Mitchell, 43 Duke L. J. at 438-39 (cited in note 99); George D. Hornstein, 1 *Corporation Law and Practice* § 439 at 544 (West, 1959) ("Nondisclosure by an interested director may itself constitute unfairness."). Even if *some* disclosure of self-dealing were required to avoid voidability per se, however, there is no reason to mandate that such disclosure necessarily be made to the stockholders, as opposed to disinterested directers.

In any event, secrecy would surely not enhance proof of entire fairness. Disclosure is a significant part of what has been described as the "fair dealing" element of entire fairness. *Weinberger*, 457 A.2d at 711. Moreover, even if fiduciary law does not mandate disclosure to stockholders of self-dealing, it encourages such disclosure by endowing informed stockholder consent to self-dealing with curative power. See note 101.

283. See Form 10-K, Item 13, as prescribed under 17 C.F.R. § 249.310, requiring annual reporting of transactions with management in accordance with Item 404 of Regulation S-K under the Securities Act of 1933. 17 C.F.R. § 229.404. See also Mahoney, 62 U. Chi. L. Rev. at 1091-93 (cited in note 265).

reduced due to the understandable unlikelihood that widely dispersed individual stockholders, each with relatively little at stake, would expend the money and effort necessary to monitor managers' actions and thereby identify instances of self-dealing.[284]

3. What Remedies are Appropriate for Failure to Fulfill the Duty of Disclosure in the Ratification Context?

This question is somewhat misleading since the ratification disclosure duty exists only as a prerequisite to defensive reliance on stockholder consent. Thus, nondisclosure is not the underlying wrong to be remedied in the context of ratification. The underlying wrong is the self-dealing transaction itself, and a disclosure shortcoming is relevant only in determining whether the transaction is supported by effective stockholder consent.[285] It is beyond the scope of this article to review extensively the range of potentially appropriate remedies for a breach of the duty of loyalty, but they clearly include rescission, injunctive relief, compensatory damages, and disgorgement of fiduciary profit.[286] Of course, an extensive, good faith effort to disclose material information in an effort to secure stockholder approval, even if flawed in some material respect, may serve as an indicium of fairness. In other words, in evaluating whether a self-dealing transaction unaccompanied by effective stockholder approval is nonetheless entirely fair, disclosure that is flawed for reasons other than bad faith or intent to deceive should be more favored by the law than none at all.[287]

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284. State corporation statutes do not universally require disclosure of self-dealing transactions or, indeed, any financial or operating information. See 3 Model Bus. Corp. Act Ann. § 16.20 at 16-77 to 16-82. For example, unlike the Model Business Corporation Act (§§ 16.20-.21), the Delaware statute is devoid of any requirement of regular reporting of corporate business. Id. at 16-82. Discovery by outside stockholders of management self-dealing must be initiated and pursued by the stockholder under statutory rights of inspection. See, for example, 8 Del. Code Ann. § 220(b); *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (Del. 1993). In light of the costs of monitoring, "it is likely tbat in a public corporation there will be less shareholder monitoring expenditures than would be optimum from the point of the shareholders as a collectivity." *Bird v. Lida, Inc.*, 1996 Del. Chanc. LEXIS 41, *9 (Apr. 4, 1996). Thus, Professor Mahoney argues for a mandatory disclosure policy applicable to public companies, albeit a policy limited to "disclosure of executive compensation and self-dealing on an ongoing basis." Mahoney, 62 U. Chi. L. Rev. at 1091-92 (cited in noto 265). Mahoney contends that such disclosure would ultimately be the norm in any event in a privately ordered system because of its efficiency in reducing agency costs. Id.

285. See text accompanying note 102.

286. *Weinberger*, 457 A.2d at 714; *ALI Principles* § 7.18(a) (cited in note 32). See also notes 318-22 and accompanying text.

287. See *Kahn v. Lynch Communications Systems, Inc.*, 1995 Del. Chanc. LEXIS 44, *5 (Apr. 17, 1995), aff'd, 669 A.2d 79 (Del. 1995) (holding that despito coercion of special committee by controlling steckholder, merger was entirely fair in part because the special committee was

C. Insider Stock Purchases and the Duty of Loyalty

The next context in which a fiduciary duty of disclosure has been identified is the purchase by a director of the corporation's stock from an outside stockholder.[288] This is a highly variable setting, as discussed below, in which the concerns of fiduciary law are not monolithic. It is a setting, however, which involves one significant difference from the ratification context discussed in the preceding section. Specifically, the conflict of economic interests is no longer between the director and the corporate entity, but rather arises between the director/stock purchaser and the outside stockholder/seller.[289] Thus, one significant aspect of fiduciary relations associated with corporate directors is missing in the stock purchase context. At least where the director purchases stock for her own account, she is not acting in a role in which the stockholder and the law have entrusted her with responsibility for managing corporate assets.[290]

Perhaps because of the absence of the asset-management underpinning of fiduciary responsibility, older case law adopted the view that directors purchasing stock from outside stockholders for their own account were under no fiduciary duty at all to disclose facts ma-

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able to engage advisors who provided assistance in negotiating and evaluating alternative transactions).

288. See Part III.B. Stock purchases by corporate fiduciaries, at least where the purchaser (and his fiduciary status) are known to the selling stockholder, are the prevailing context in which the case law addresses fiduciary issues. While much of what is said here could apply to the case in which a director sells her stock directly to an outside stockholder on the basis of inside information in order to avoid a loss, that factual context is at best unusual. Hence, the discussion here speaks of purchases of stock by the fiduciary from the outside stockholder, rather than sales of stock by the fiduciary to the outside stockholder.

289. See *Eisenberg v. Chicago Milwaukee Corp.*, 537 A.2d 1051, 1057 (Del. Chanc. 1987) (holding that in the context of a self-tonder offer approved by directors owning a controlling block of stock, "[t]he interest of the corporate offeror (*qua* buyer) is to pay the lowest price possible; the intorest of the stockholders (*qua* sellers) is to receive as high a price as possible").

290. See, for example, Michael Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 Cornell L. Q. 53, 55 (1960). Such a role *is* implicated, of course, where the corporation is the purchaser of stock and corporate assets are used to fund the purchase. With this additional underpinning of fiduciary responsibility in place, courts have not hesitatod to impose fiduciary duties of disclosure on managers who bring about such stock repurchases. See, for example, *Northern Trust Co. v. Essaness Theatres Corp.*, 348 Ill. App. 134, 108 N.E.2d 493 (1952). *Northern Trust* distinguishes cases where the director purchases stock for his own account, and observes that: "[D]irectors occupy the position of trustees for the stockholders as a body and cannot have or acquire any personal or pecuniary interest in conflict with their duty as such trustoes. That is to say, when they act on behalf of the corporation, they occupy the position of trustoe to each individual stockholder." Id. at 498. See also *Adams v. Mid-West Chevrolet Corp.*, 198 Okla. 461, 179 P.2d 147, 156 (Okla. 1946). One court has suggested, however, that this distinction between corporate repurchases and purchases by a director for her own account is "illogical." *Guy v. Duff and Phelps, Inc.*, 672 F. Supp. 1086, 1091 (N.D. Ill. 1987).

terial to the transaction.[291] This view, however, misconceives the fiduciary rationale of the disclosure duty. The force animating the cases imposing such a duty is the fact that it is the stockholders who retain and compensate managers, and it is the managers' use of corporate resources that enables them to gather material information. To permit the managers to use that information for their own personal benefit and to the disadvantage of those who have effectively funded its acquisition runs counter to fundamental agency principles of unjust enrichment.[292] Some commentators have also argued that permitting managers to profit from stock purchases made using material inside information tends to increase the risk perceived by investors in providing equity capital, and thereby increases the cost of such capital.[293]

One could respond that outside stockholders, aware that they are dealing with a director, could simply negotiate to obtain a warranty that they have been provided with all material information. Failing to obtain such a warranty, the stockholder could either refrain from selling stock to the director or proceed knowing of the uncertainty of the informational base. None of these alternatives, however, can be viewed as efficient. Individualized negotiation of disclosure obligations would impose substantial transaction costs, particularly where a purchase offer is extended to many outside stockholders, as where a controlling stockholder makes a public tender offer for minority-held shares. Insisting, in the absence of such individualized negotiation, that stockholders refrain from trading with the fiduciary or accept the risk of inadequate information could only result in decreased stock prices and increased costs of equity capital.[294]

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291. *Goodwin v. Agassiz*, 283 Mass. 358, 186 N.E. 659, 660 (1933) (citing "an imposing weight of authority in other jurisdictions" for the proposition that the stock purchaser's director status creates no fiduciary relation to the selling stockholder). See also Finn, *Fiduciary Obligations* at 65 (cited in note 250); Shepherd, *Law of Fiduciaries* at 355-56 (cited in note 49); Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 Wash. & Lee L. Rev. 1189, 1219 (1995).

292. See, for example, *Brophy*, 70 A.2d at 7-8; *Tarnowski v. Resop*, 51 N.W.2d 801, 802-03 (Minn. 1952); Restatement (Second) of Agency §§ 388 cmt. c, 395, 404 (1958). See also Conant, 46 Cornell L. Q. at 75 (cited in note 290). Bainbridge questions the reach of these agency principles, but ultimately acknowledges a "trend in the case law . . . towards imposing fiduciary duties on insiders." Bainbridge, 52 Wash. & Lee L. Rev. at 1224-26 (cited in note 291). See also Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 Cal. L. Rev. 1, 5, 6 n.17 (1982).

293. See John C. Coffee, Jr., *No Exit? Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 Brooklyn L. Rev. 919, 945-46 (1988); James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 Duke L. J. 628, 637-38 (1986); Roy A. Schotland, *Unsafe At Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 Va. L. Rev. 1425, 1438-41 (1967).

294. See note 290.

In contrast, imposing a fiduciary duty of disclosure provides a convenient, ready-made substitute for what selling stockholders would want in any event—presentation of the material facts—and what directors, by virtue of their role as centralized repositories of corporate information, are well suited to provide efficiently.[295] That transaction cost-minimizing rationale for imposing a fiduciary disclosure duty would not apply, of course, in the case of stock purchases by directors in impersonal, market transactions, in which the seller is unaware of the identity of the buyer. In that situation, there would be no occasion for negotiation over the seller's disclosure. Perhaps tacitly recognizing that no negotiation transaction costs would be avoided in this setting by establishing a fiduciary duty to disclose material facts to the selling outside stockholder, the case law has generally prescribed none.[296]

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295. See Cox, 1986 Duke L. J. at 656-59 (cited in note 293); Frankel, 71 Cal. L. Rev. at 833, 835 (cited in note 250).

Professor Dooley has argued that the absence of a fiduciary duty of disclosure when directors of public companies purchase stock from outside stockholders is "firmly based on efficiency considerations." Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 64 (1980). Insider trading profits, he argues, provide incentive to managers to develop information useful to the wealth of the enterprise, and which will inure to the benefit of stockholders as a whole, where the managers are unable to acquire any more than a small percentage of the outstanding shares using their inside information. Id. at 66. In other words, some hapless public stockholders must be allowed to sell their stock at an unfairly low price, without the benefit of material inside information that the purchasing director may not have expended any effort in acquiring, in order to provide some haphazard, fortuitous inducement to managers generally to gather valuable information so that they and the fortunate non-selling public stockholders can benefit—assuming, of course, that we are not dealing with a management buyout in which *all* publicly held shares are acquired by insiders. This compensation theory for rejecting a fiduciary disclosure duty has been criticized as "inefficient." Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 11 S. Ct. Rev. 309, 332 (1981). See also Cox, 1986 Duke L. J. at 651-52 (cited in note 293).

296. *Goodwin*, 186 N.E. at 659, is probably the leading authority in this context. *Goodwin*, which involved a claim for damages by a stockholder who sold in an impersonal market transaction, must be distinguished, however, from cases in which the corporation, usually in a derivative suit, seeks to recover the director's trading profits. See generally *Frankel v. Slotkin*, 984 F.2d 1328, 1336-37 (2d Cir. 1993); *National Westminster Bancorp NJ v. Leone*, 702 F. Supp. 1132, 1139 (D.N.J. 1988); *In re ORFA Securities Litigation*, 654 F. Supp. at 1449 (D.N.J. 1987); *Coleco Securities Litigation*, 591 F. Supp. 1488, 1494-95 (S.D.N.Y. 1984); *Ferris v. Polycast Technology Corp.*, 429 A.2d 850, 853 (Conn. 1984); *Katz Corp. v. T.H. Canty & Co.*, 362 A.2d 975, 980 (Conn. 1975); *Brophy*, 70 A.2d at 5; *Diamond v. Oreamuno*, 248 N.E.2d 910 (N.Y. 1969). Research has not disclosed any case in which a stockholder selling in the market has successfully invoked fiduciary disclosure duty, as opposed to Rule 10b-5, to recover compensatory damages from a director who concurrently bought stock. In any event, the more recent cases in the *Oreamuno* line, even while recognizing the existence of a derivative claim of breach of fiduciary duty, have tended to limit recovery to losses sustained by the corporation, if any such losses can be proven, and have declined to authorize recovery of the insider's trading gains. See, for example, *Frankel*, 984 F.2d at 1336-37 (stating that the "[b]reach of fiduciary obligation is a tort claim, and thus requires the showing of a duty, a breach, an injury, and causation"); *In re ORFA*, 654 F. Supp. at 1457. See also *Schein v. Chasen*, 313 So.2d 739, 746 (Fla. 1975) (rejecting vicarious tippee liability). Moreover, not all courts even accept the

There is a further basis in fiduciary principles to impose a duty upon directors when they purchase stock directly from outside stockholders. The role of directors as corporate managers casts upon them the function of gatherers and holders of material corporate information, upon whom the outside stockholders reasonably, indeed necessarily, rely when the directors seek to acquire their shares.[297] That reliance on managers as a source of superior information is a traditional earmark of a fiduciary relationship of dependence, one that independently supports the application of a fiduciary duty of disclosure in the situation where an outside stockholder is approached by a director seeking to purchase his shares.[298] The absence of such a disclosure duty in arm's length relationships appropriately discourages such reliance in the interest of rewarding diligence in the gathering of information.[299] That approach is counterproductive, however, in the corporate setting, particularly where the number of stockholders is large, because it discourages the specialization of function, including information gathering, that the corporate structure usefully exploits.[300] Hence, a fiduciary duty to disclose material facts appropriately inheres in a director's purchase of stock directly from an outside stockholder.

With that introduction to the application of fiduciary principles in the stock purchase context,[301] the character of the fiduciary disclosure duty in that context can be sketched out, again using questions and answers.

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premise that insider trading in the market constitutes a breach of fiduciary duty to the corporation. See, for example, *Freeman v. Decio*, 584 F.2d 186 (7th Cir. 1978); *Daisy Systems Corp. v. Feingold*, 1989 Fed. Secur. L. Rptr. (CCH) ¶ 94,520, at 93,311 (N.D. Cal. 1988).

As Professor Bainbridge points out, "the American Law Instituto's corporate governance project opines that duty to refrain from self-dealing in confidential corporate information exists in both face-to-face and stock exchange transactions." Bainbridge, 52 Wash. & Lee L. Rev. at 1226 (cited in note 291) (discussing *ALI Principles* § 5.04(a) (cited in note 32)). Bainbridge quickly cautions, however, that "the only citation of support offered by the Reporter for the proposition that this duty extends to secondary market transactions is a 'but see' cito to *Goodwin*." Id. at 1226 n.161 (citing *ALI Principles* § 5.04 at 377 (cited in note 32)).

297. See noto 260.

298. See noto 333.

299. See Seligman, 73 Geo. L. J. at 1091-93 (citod in note 124) (citing Anthony T. Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. Legal Stud. 1, 11-12 (1978)).

300. See note 260.

301. One cannot proceed further with the analysis of the fiduciary disclosure duty of directors in the stock purchase contoxt without noting the potential significance of stato law to the reach of the federal insider trading laws. See, for example, *Dirks v. SEC*, 463 U.S. 646, 653 (1983); *Chiarella v. United States*, 445 U.S. 222, 232 (1980); *United States v. Chestman*, 947 F.2d 551, 568 (2d Cir. 1991); Bainbridge, 52 Wash. & Lee L. Rev. at 1268 (cited in note 291) ("[T]he fiduciary duty element required by the federal definition of insider trading should be supplied solely by stato corporate law.").

1. Who Owes the Fiduciary Duty of Disclosure?

This question is easily answered by reference to the circumstances giving rise to the fiduciary duty of disclosure in the stock purchase context. As previously discussed, the fiduciary duty arises because of the use by the fiduciary of information, learned through the performance of the fiduciary management function, in acquiring stock directly from outside stockholders.[302] Thus, the duty can rest not only upon directors but upon corporate officers[303] and controlling stockholders[304] as well. Those who actively participate with such corporate managers in the purchase of stock may take on indirect responsibility for adequate disclosure,[305] but any direct fiduciary duty of disclosure on their part seems unjustified in light of the rationales of the fiduciary duty.[306]

2. In What Specific Circumstances is the Duty Owed?

The fiduciary duty of disclosure arises in the context of the acquisition of stock by a director directly from an outside stockholder, whether that acquisition occurs in a privately negotiated purchase, through a public tender offer, or through a merger effected by means of a vote of public stockholders.[307] Of similar fiduciary substance is the acquisition of outsider stock by the corporation itself, where caused by managers who have a sufficient ownership interest in the corporation so that their personal, albeit indirect, economic interest in respect of the repurchase conflicts materially with the stockholder's interest in receiving maximum value. The important aspect here is that the transaction arises by virtue of a volitional act on the part of the public stockholders affected by the purchase, whether that volitional act is a sale agreement, a tender in response to a tender offer, or the vote of the publicly held shares.

Where such volition on the part of the public stockholders whose shares are purchased is lacking—as in the case of a squeeze-

302. See text accompanying notes 297-300.

303. See, for example, *Mansfield Hardwood Lumber*, 263 F.2d at 754.

304. See, for example, *Shell*, 606 A.2d at 114; *Kahn*, 591 A.2d at 171; *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 846 (Del. 1987); *Weinberger*, 457 A.2d at 711; *Lynch*, 383 A.2d at 279.

305. See note 276.

306. See note 277. See also *Citron v. Fairchild Camera and Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989); *ALI Principles* § 5.04 at 270-71 (cited in note 32).

307. *Mansfield Hardwood Lumber*, 263 F.2d at 748 (privately negotiated purchase); *Joseph v. Shell Oil Co.*, 482 A.2d 335 (Del. Chanc. 1984) (tender offer by majority stockholder); *Weinberger*, 457 A.2d 701 (merger conditioned upon vote of majority of minority shares voting).

out merger effected solely by means of the vote of the shares of a controlling stockholder—the fiduciary considerations are very different.[308] Certainly, the transaction cost reduction rationale for the fiduciary disclosure duty is absent where, as in the squeeze-out merger, there is no opportunity for negotiation.[309] Nevertheless, the element of reliance on the fiduciary's superior informational resources may still be present, even when there is no stockholder agreement to, or vote for, a sale. Stockholders usually must still choose whether to exercise appraisal rights.[310] For just such reasons, a fiduciary duty of disclosure has been applied in mergers unilaterally effected by majority stockholders.[311]

A more attenuated form of conflict—a conflict of roles rather than of economic interest in the transaction—exists with respect to corporate stock repurchases generally. Some courts have suggested that where directors approve stock repurchases, even in the absence of any personal stock interest, they take on fiduciary disclosure obligations because they are serving the conflicting interests of those persons who sell their shares and those stockholders who retain their equity interest in the corporation.[312] That suggestion was made in a case in which the directors, representatives of holders of a controlling block of common stock, did in fact have a potent personal interest in achieving the lowest possible repurchase price for shares of preferred stock. In the case of a stock repurchase in which the directors have no such material conflicting interest, however, the central concern of fiduciary law over abuse of position for self-aggrandizement is absent. Only the fiduciary aspect of reliance upon directors on account of their information-repository function remains.[313] Accordingly, the fiduciary disclosure duty in this disinterested circumstance should resemble

308. The Delaware Court of Chancery has held, in fact, that a stockholder who does not tender shares in a self-tender offer lacks standing to challenge the sufficiency of disclosure on a fiduciary duty theory, since no change of control or second-step squeeze-out transaction results from the tender offer, and the stockholder otherwise suffers no cognizable effect. *Abajian v. Kennedy*, 1992 Del. Chanc. LEXIS 6, *25-26 (Jan. 17, 1992).

309. See text accompanying note 296.

310. See, for example, 8 Del. Code Ann. §§ 253(d), 262(b).

311. See note 193.

312. *Eisenberg*, 537 A.2d at 1057-58 (pointing out that in a stock repurchase, directors "are acting both as the representatives of the corporate offeror and as fiduciaries for the sbareholder offerees . . . necessarily giv[ing] rise to a potential conflict of the directors" justifying an "onerous disclosure standard") (citing *Blanchette v. Providence & Worcester Co.*, 428 F. Supp. 347, 356 (D. Del. 1977); *Broder v. Dane*, 384 F. Supp. 1312, 1318-19 (S.D.N.Y. 1974)).

313. Where open market repurchases are concerned, even that element of fiduciary principles is absent. The identity of the purchaser is unknown, and presumably irrelevant, to the seller. No fiduciary duty of disclosure has ever been identified in tbat circumstance, and none should be.

the more limited duty, discussed in Part V.D, that exists generally when disinterested managers present a proposal to stockholders for voting or action that may affect the value of their stock, rather than the more stringent version of the fiduciary duty that exists in regard to self-interested stock purchases by corporate managers.

3. Is the Disclosure Duty Affirmative, or Does it Merely Require Avoidance of Material Misrepresentation or Incompleteness?

In the context of publicly held companies, federal law makes this question largely academic. Federal law prescribes mandatory disclosures whenever directors or controlling stockholders seek to acquire publicly held shares by means of a tender offer or merger.[314] With open market stock repurchases approved by disinterested directors not subject to any fiduciary disclosure duty,[315] and privately negotiated purchases between directors and public stockholders relatively rare, state fiduciary disclosure law in this area has largely addressed questions of material omission in federally mandated disclosure documents.[316]

To the extent that the issue arises in the context of privately held companies and is therefore not preempted as a practical matter by the federal securities laws, the fiduciary duty of disclosure of a director purchasing stock from an outside stockholder should be characterized as a duty of affirmative disclosure, and not merely avoidance of material misrepresentation or misleading incompleteness. The fiduciary considerations are quite similar to those in the context of ratification of self-dealing. The director's personal economic interest in acquiring stock as cheaply as possible is adverse to the interest of the selling stockholder. The director is enabled to pursue that interest, to the detriment of the stockholder, by virtue of (1) access to information gained while carrying out the management function; and (2) the stockholder's necessary reliance on the director for material information concerning the transaction. With all these considerations present, the stockholder's consent to the director's stock purchase can no more be considered valid in the absence of full disclosure of material facts within the director's control than could the stockholder's

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314. See, for example, 17 C.F.R. §§ 240.13e-3 et seq., 240.14d-1 et seq.

315. See note 313.

316. See, for example, *Myzel v. Fields*, 386 F.2d 718, 733 (8th Cir. 1967); *Mansfield*, 263 F.2d at 752; *Kahn*, 591 A.2d at 170-71; *Weinberger*, 457 A.2d at 712; *Lynch*, 383 A.2d at 281. But see *Shell Petroleum*, 606 A.2d at 113 (holding that the understatement of discounted future net cash flows from oil and gas reserves was a material omission).

consent to a self-dealing transaction between the director and the corporation. Indeed, the stock purchase achieved without adequate disclosure could be considered more suspect, since it cannot even occur without the improperly secured volitional act of the selling stockholder.

4. What Are the Appropriate Remedies for Breach of the Fiduciary Duty of Disclosure in the Stock Purchase Context?

This question is one on which the case law, at least in Delaware, is fairly well developed. And, as one might expect given the equitable foundations of fiduciary law,[317] the range of potential remedies is extensive—again evidencing the similarity of fiduciary principles applicable in the stock purchase context and the more traditional self-dealing context. Potentially available remedies for a breach of the fiduciary duty of disclosure in connection with a stock purchase from an outside stockholder include rescission,[318] injunctive relief,[319] compensatory damages,[320] and disgorgement of fiduciary profit.[321] Indeed, where problems of evaluating compensatory damages from disclosure shortcomings in stock purchases have proved difficult, the Delaware courts have resorted to the use of somewhat arbitrary monetary awards, which have been characterized, not altogether accurately, as "nominal damages."[322] These cases have led the Delaware Supreme Court to state that "[i]n Delaware existing law and policy have evolved into a virtual *per se* rule of damages for breach of the fiduciary duty of disclosure."[323] That approach to remedy—awarding damages in the absence of harm to the beneficiary—is

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317. *Harman v. Masoneilan International, Inc.*, 442 A.2d 487, 497-98 (Del. 1982); Shepherd, *Law of Fiduciaries* at 13 (cited in note 49); Finn, *Fiduciary Obligations* at 1 (cited in note 250).

318. *Myzel*, 386 F.2d at 742; *Mansfield*, 263 F.2d at 750; *Joseph*, 482 A.2d at 344-45.

319. *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A.2d 1324, 1335 (Del. Chanc. 1987).

320. *Shell Petroleum*, 606 A.2d at 113; *Weinberger*, 457 A.2d at 701.

321. *Myzel*, 386 F.2d at 742; *Mansfield*, 263 F.2d at 750; *Lynch*, 429 A.2d at 503 n.5.

322. *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 475 (Del. 1992); *Smith v. Shell Petroleum, Inc.*, 606 A.2d 112 (Del. 1992); *Weinberger*, 497 A.2d at 792.

The sums awarded in these fiduciary duty of disclosure cases—$1 or $2 per share to a class consisting of millions of shares—do not comport with generally accepted definitions of "nominal damages." See, for example, *Carey v. Piphus*, 435 U.S. 247, 266 (1978); *Guthridge v. Pen-Mod, Inc.*, 239 A.2d 709, 714 (Del. Super. Ct. 1967) ("Nominal damages are assessed in some trifling or trivial amount, such as six cents or one dollar . . . ."); Restatement (Second) of Torts § 907 (1977) ("Nominal damages are a trivial sum of money awarded to a litigant who has established a cause of action but has not established that he is entitled to compensatory damages."); Dan B. Dohbs, *Handbook On The Law Of Remedies* § 3.8 at 191 (West, 1973) ("Nominal damages, as the term implies, are damages in name only, that is, in trivial sums such as six cents or $1 or $10.").

323. *Tri-Star Pictures*, 634 A.2d at 333.

well-grounded in precedent in cases in which fiduciaries act disloyally, out of self-interest in conflict with those they are charged with representing.[324] As we see in Part V.D, however, it is hardly appropriate as a general approach to the treatment of fiduciary disclosure problems where no conflicting personal interest is at stake.

D. Disinterested Recommendations of Stockholder Action

The next context of fiduciary disclosure obligations to consider is the common situation in which disinterested directors ask stockholders to vote or otherwise take action on a matter as to which the directors have made a recommendation. Usually by statute[325] or implementing regulation,[326] the law has set up directors as the source of an initial judgment about a proposed transaction, and thereby, efficiently and appropriately, set up in stockholders a reasonable reliance on the directors' recommendation.[327] The disinterested aspect of the matter, however, completely eliminates a central concern of fiduciary doctrine, namely the handling of conflicts of interest.[328]

Indeed, some commentators have suggested that disclosure obligations in this context are not even properly described as "fiduciary," but rather as based on ordinary tort principles of deceit or negligence.[329] This effort to differentiate the principles underlying what are traditionally considered the duties of loyalty and care is

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324. See, for example, *Guth*, 5 A.2d at 510; Scott and Fratcher, 3 *Law of Trusts* § 205 at 239 (cited in note 49); Bogert and Bogert, *Trusts and Trustees* § 543(V) (cited in note 108).

325. See, for example, 8 Del. Code Ann. §§ 242 (charter amendments), 251 (mergers), 271 (sales of all or substantially all assets), 275 (dissolution). See also Model Bus. Corp. Act Ann. §§ 10.03(b)(1) (charter amendments), 11.03(b)(1) (mergers and share exchanges), 12.02(b)(1) (sales of assets other than in regular course of business), and 14.02(b)(1) (voluntary dissolution).

326. Federal law requires directors of registered companies to issue a recommendation with respect to a tender offer for the corporation's shares. 17 C.F.R. § 240.14-e2.

327. See note 260. In *Van Gorkom*, the Delaware Supreme Court underscored the importance of the duty of the board of directors, under a corporate merger statute, to make the initial judgment whether to enter into a merger agreement: "Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement." 488 A.2d at 873.

328. See DeMott, 1988 Duke L. J. at 908 (cited in note 250) (characterizing the "central preoccupation of fiduciary obligation" as "minimizing potential or incipient conflicts in parties' interests").

329. Shepherd, *Law of Fiduciaries* at 245-48 (cited in note 49) ("Where it is proved that one person reasonably relied on the advice or information of another, a fiduciary relationship may arise. . . . Where the advice or information is unsound, and . . . no bias has in fact been proved, the fiduciary may be held liable for the tort of negligent misrepresentation under normal tert principles."). Shepherd's rejection of a fiduciary underpinning of a disinterested disclosure duty stems from his position that the "duty of care has no essential connection with the fiduciary relationsbip," as it "arises not only in fiduciary situations, but also in contractual and tortious situations." Id. at 48-49, 247.

helpful, particularly since it exposes the close analogy between the tort of negligent misrepresentation and the fiduciary disclosure duty of disinterested directors when they recommend stockholder action.[330] It must be acknowledged, though, that there is simply too much history to conclude that the duty of care in the management of trust affairs lacks any fiduciary content.[331] Moreover, to say that a disinterested director's duty of disclosure to stockholders is not a fiduciary duty could rule out the use of a charter provision to eliminate damages liability for breach of that duty.[332]

In all events, reliance on a person possessed of superior information and acting as an adviser has persistently been characterized as one model of fiduciary relationship.[333] This model does not ordinarily apply to corporate directors, who are not generally considered to be agents for stockholders, discharging their ordinary management responsibilities subject to the direct control of stockholders as principals.[334] The situation is different, however, where directors counsel stockholders with respect to actions as to which stockholders do have decisionmaking power. Where such power—approval of a merger, or sale of stock in a tender offer, for example—is exercised by stockholders following a recommendation or advice by directors, the analogy to

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330. See text accompanying notes 354-56.

331. *Van Gorkom*, 488 A.2d at 872 ("A director's duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders."); *Glinert v. Wickes Cos.*, 16 Del. J. Corp. L. 764, 780 (1991), aff'd, 586 A.2d 1201 (Del. 1990) (stating that the law of fiduciaries subjects managers' conduct "to review when a claim of disloyalty *or lack of due attention* is made") (emphasis added)); *Francis v. United Jersey Bank*, 87 N.J. 15, 432 A.2d 814, 824 (N.J. 1981) (finding a director in breach of the duty of care, noting that "the relationship of a corporate director te the corporation and its stockholders is that of a fiduciary"); Robert W. Hamilton, *Corporations* 465 (3d ed. 1992) (identifying the duty of care within "the scope of fiduciary duties owed by directors").

Moreover, trustees owe a duty to exercise care under ordinary trust law. Rostatement (Second) of Trusts § 174 (1959); Bogert and Bogert, *Trusts and Trustees* § 541 at 167 (cited in note 108); Scott and Fratcher, 2A *Law of Trusts* § 174 (cited in note 49); Langbein, 105 Yale L. J. at 656 (cited in note 250).

332. See *Arnold*, 650 A.2d at 1286-88. The relevant Delaware statuto permits limitation of liability only for "breach of *fiduciary* duty as ą director." 8 Del. Code Ann. § 102(b)(7) (emphasis added).

333. An agent who gives advice te a principal who relies on that advice, at least where the agent possesses superior knowledge, must disclose information material to the principal's decision. Restatement (Second) of Agency § 381 at 182 (1958). This principle has been found applicable in dealings between real estate brokers and their clients, *Licari v. Blackwelder*, 539 A.2d 609, 613 (Conn. App. 1988), *Urban Investments Inc. v. Branham*, 464 A.2d 93, 96 (D.C. 1983), *Hurney v. Locke*, 308 N.W.2d 764, 768 (S.D. 1981), *Quechee Lakes Rental Corp. v. Boggess*, 608 A.2d 39, 41 (Vt. 1992); securities brokers and their clients, *Merrill Lynch, Pierce, Fenner & Smith v. Perelle*, 514 A.2d 552, 560-61 (Pa. Super. Ct. 1986); and lawyers and their clients, *Grunwald v. Bronkesh*, 621 A.2d 459, 464 (N.J. 1993). See also Shepherd, *Law of Fiduciaries* at 28-32 (cited in note 49); Finn, *Fiduciary Obligations* at 50-51 (cited in note 250).

334. See, for example, *New York Dry Dock v. McCollom*, 16 N.Y.S.2d 844, 847 (N.Y. Sup. 1939). See also note 260.

the agency relationship and its concomitant fiduciary disclosure obligations is more forceful.[335]

Moreover, to the considerable extent that information gathered in the management of the corporation can be considered a corporate asset subject to the directors' management responsibilities,[336] it can be said that the directors' duty of care in presenting a recommendation for stockholder action requires management of that information for the benefit of the stockholders. That is, directors should disseminate such information where it is of material significance to the stockholders' decision and the utility of the information to stockholders is not outweighed by harm from disclosure.[337]

Attempting to describe the disinterested director's disclosure duty as a subset of the traditional duty of care, however, reveals a striking, although not necessarily grating, incongruity with traditional due care jurisprudence. A rational decision by disinterested, duly informed directors in the management of the business affairs of the corporation is ordinarily thought to be beyond the realm of judicial intervention.[338] In contrast, whether a fact is material and must be disclosed to stockholders is not a matter on which the courts have given any deference, presumptive or otherwise, to the business judg-

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335. See text accompanying notes 19-21.

336. This perspective on corporate information is not at all novel. A particularly clear articulation of the perspective is found in a 1903 opinion of the Georgia Supreme Court identifying a duty on the part of a corporate director and officer to disclose to an outside steckholder a proposed sale of corporate assets prior te acquiring the outsider's stock: "In a certain sense the information is a quasi asset of the company, and the shareholder is as much entitled to the advantage of that sort of an asset as to any other regularly entered on the list of the company's holding." *Oliver v. Oliver*, 118 Ga. 362, 45 S.E. 232, 234 (1903). See also *Childs v. RIC Group*, 331 F. Supp. 1078, 1082 (N.D. Ga. 1970); Shepherd, *Law of Fiduciaries* at 330-31 (cited in note 49).

The notion that corporate information is to be managed for the benefit of the steckholders underlies judicial approval of the use of internal corporate data as an inducement to potential bidders to accede to auction rules designed to secure the highest reasonably available price in a sale of the company. See, for example, *Alliance Gaming Corp. v. Bally Gaming Int'l., Inc.*, 1995 Del. Chanc. LEXIS 101 (Aug. 11, 1995); *In re J.P. Stevens & Co., Inc. Shareholders Litigation*, 542 A.2d 770, 784 (Del. Chanc. 1988); *Confidentiality and Standstill Agreements: Battleground for Control of the Process*, Corporate Control Alert (May 1988) (describing Delaware Court of Chancery ruling denying injunction requiring target company to afford access to intornal data to a bidder unwilling to sign a standstill agreement, and quoting target company counsel's defense of the company's position as "a plausible method of running the bidding process to maximize shareholder value").

337. See note 187.

338. See, for example, *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). See also Block, *Business Judgment Rule* at 11-19 (cited in note 30); S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 Hofstra L. Rev. 93, 111-12 (1979); Dooley, 47 Bus. Law. at 471-72 (cited in note 260).

ment of management responsible for preparing proxy statements or similar disclosure documents.[339]

Thus, although courts purport to disavow any role in second-guessing disinterested business decisions, they do not shrink from determining *de novo* whether a fact is significant enough to be considered material to a business decision by stockholders.[340] The judicial role in evaluating whether directors have fulfilled a recommendation duty of disclosure, then, is considerably more active than the role adopted in reviewing, under the rubric of the duty of care, the fulfillment of other management fiduciary responsibilities.[341]

To view the duty of disclosure of disinterested directors entirely as the product of the duty of care, moreover, leaves one further analytical loose end, best illustrated by a variation of the hypothetical situation discussed in introducing this article.[342] Assume that plaintiff's counsel discovers the arguably material omission in time to present an application for a preliminary injunction. As Chancellor Allen observed in *Anderson Clayton*,[343] it seems most likely that a court would enjoin the transaction, pending curative disclosure to stockholders, upon finding that existing disclosures are materially deficient, even though the directors' failure to disclose was the product of informed deliberation.[344] Yet, in the absence of any director conflict of interest, and given the exercise of due care in preparing the merger proxy material, one would ordinarily conclude that there could be no issue of breach of either the duty of loyalty or the duty of care.

On what theory of liability, then, would such a preliminary injunction rest?[345] The only intellectually satisfying answer is some strict duty of disclosure, akin to that posited for trustees,[346] that can

339. See notes 19-21 and accompanying text.

340. See cases cited in notes 18, 167, 241, and 307. See also Mitchell, 43 Duke L. J. at 472-73 (cited in note 99).

341. See *Anderson Clayton*, 519 A.2d at 676-78 (allowing that rejection of a hostile competing offer could "be a rational choice," but enjoining consummation of a management-sponsored recapitalization due to inaccurate characterization, in solicitation of stockholder votes to approve the recapitalization, of management's intentions regarding further exploration of the hostile bid); Oesterle and Palmiter, 79 Iowa L. Rev. at 565 (cited in note 30) ("State judges (principally in Delaware) place themselves in the omnipotent position of the 'reasonable shareholder' to review management disclosure under a common-law fiduciary standard of 'complete candor.' ").

342. Part I.B.

343. 519 A.2d at 669.

344. Id. at 675.

345. Proof of a likelihood of ultimate success on the merits is traditionally considered a prerequisite to preliminary injunctive relief. See, for example, *Doran v. Salem Inn, Inc.*, 422 U.S. 922, 931 (1975); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986).

346. See note 188.

be breached despite good faith, disinterest and due care. As anyone contemplating the contours of any such fiduciary duty must inevitably observe, however, to say that there is a fiduciary duty only begins the analysis.[347]

To understand a fiduciary recommendation duty of disclosure, one must at the outset consider the limited scope of that duty. The duty is an obligation to use reasonable care in presenting a recommendation for stockholder action and in gathering and disseminating corporate information in connection with that recommendation. The tort doctrine of negligent misrepresentation is powerfully analogous; it prescribes that one who "in the course of his business" negligently supplies false information "for the guidance of others" is liable for pecuniary loss caused by justifiable reliance upon that information.[348] The information supplier's duty extends, however, only to the "limited group of persons for whose benefit and guidance he intends to supply the information," and engenders liability only "in a transaction that he intends the information to influence."[349] Just so, a director, when he recommends stockholder action, is acting "in the course of his business" to supply information "for the guidance of others," namely the "limited group" consisting of the stockholders, with respect to "a transaction that he intends the information to influence."[350]

Accordingly, the director's duty in the recommendation context is not discharged merely by presenting the facts known to her personally. As under the negligent misrepresentation formulation requiring that the provider of information "exercise reasonable care or competence in obtaining or communicating the information,"[351] the presentation of corporate information accompanying a recommendation to stockholders is a management function which must be discharged through reasonable steps to assure that material information is gathered from the corporate officers and employees reasonably likely to

347. *SEC v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943) (Frankfurter, J.) ("To say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?").

348. As stated by the Second Restatement of Torts:

> One who, in the course of his business, profession or employment... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Restatement (Second) of Torts § 552(1) (1977).

349. Id. § 552(2).

350. Id.

351. Id.

possess such information.[352] As a corollary, of course, a director does not fail to discharge his recommendation disclosure duty if, after taking such steps, a material fact fails to come to light because of neglect or mistake on the part of an employee or agent to whom some portion of the information gathering task has been reasonably delegated.[353]

These considerations of fiduciary doctrine, and the doctrine of negligent misrepresentation they parallel, also shed light on the questions of who owes the recommendation disclosure duty, when it is owed, what disclosure it mandates, and what remedies exist for its violation. The balance of this section addresses those now familiar questions.

1. Who Owes the Recommendation Duty of Disclosure?

As with the ratification and stock purchase disclosure duties discussed in previous sections,[354] identifying the fiduciary rationale for the duty identifies those who owe the duty. Since the exercise of the management function of making a recommendation of an action, or inaction, to stockholders activates fiduciary responsibilities, those who are responsible for and make the recommendation—the directors of the corporation—owe the duty of disclosure.[355]

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352. In reviewing this article, Professor Langevoort commented perceptively that a negligent misrepresentation model of the recommendation disclosure duty of directors might afford stockholders a remedy for director inattention not amounting to "gross negligence." This is contrary to established Delaware law requiring proof of "gross negligence" as a predicate to a breach of the fiduciary duty of care. See note 267 and accompanying text. The concern is that a director's failure to take note of a material fact might become actionable because of its nondisclosure to stockholders in connection with recommending a transaction, while that same failure might not be so negligent as to constitute a breach of the duty of care.

This concern may be more troubling in theory than in practice. Despite any superficial variance in the language of the standards of culpability—that is, between the substantive due care test and the negligent misrepresentation model—it seems unlikely that a court would validate a director's decision despite a failure to ascertain a material fact but nevertheless hold that same director personally liable for a failure to disclose that fact in recommending stockholder action. Perhaps the line between ordinary negligence and "gross negligence" is overdrawn. See, for example, Quillen, 10 Del. J. Corp. L. at 500 (cited in note 153) ("[I]n information gathering, a negligence standard without the superlatives may be appropriato so long as courts recognize that 'circumstances' vary. Such a standard would not be materially different in result than the 'gross negligence' standard of *Trans Union* . . . ."); Arsht, 8 Hofstra L. Rev. at 101-11 (cited in note 338). In any event, there is no intent to suggest here a more stringent rule of director liability for inattention in gathering material information.

353. See, for example, *Rosenblatt*, 493 A.2d at 943; *ALI Principles* § 4.01(b) cmt. b at 170-72 (cited in note 32).

354. Parts V.A and B.

355. Thus, there is some merit in the suggestion by Professor Solomon that "[s]tate regulation of proxy solicitations is a logical outgrowth of state statutes governing notice to shareholders of shareholder meetings." *Corporations Law* at 841 (cited in note 30). Contrary to one

2. When Does the Recommendation Disclosure Duty Arise?

Again, the fiduciary rationale answers the question. As stated repeatedly in the Delaware cases, "the obligation attaches to proxy statements and any other disclosures in contemplation of stockholder action"[356]—that is, when the directors make a recommendation that the stockholders vote, sell, not sell, or otherwise take action in regard to their shares. The disclosure obligation may thus attach in the context of the election of directors, at least where the directors recommend and solicit stockholder action—voting for their nominees—that importantly affects the management of the corporation.

Fiduciary analysis, however, suggests several limitations on the scope of the recommendation disclosure duty. First, there is a legitimate management role to be played by directors in determining whether disclosure of even material information should be limited or dispensed with altogether in connection with a recommendation to stockholders, where public disclosure of such information might cause harm to the interests of the corporation and its stockholders that would outweigh the benefits of disclosure. Confidential information about a mineral discovery, to take a familiar example,[357] might be highly material to a board of directors' recommendation of a merger in which stockholders receive the acquiring firm's stock. Yet a disinterested board must have some authority to make a judgment that public disclosure of the discovery would be inadvisable in light of the potential benefits of secrecy. In a closely held company, there may be practical ways, such as the execution of confidentiality agreements, to resolve the competing interests of disclosure to stockholders and avoidance of injurious publicity.[358] Where such accommodation is impossible as a practical matter, an informed director determination that the likely harm from disclosure outweighs the benefit should

possible reading of *Stroud*, the existence of a duty of disclosure is dependent upon the fiduciary recommendation, and can exist as *Stroud* itself suggested, see text accompanying notes 217-19, even in the absence of management solicitation of proxies. Nevertheless, as the Delaware Supreme Court has now made clear, the disclosure duty is that of the directors making the recommendation, and not that of the corporation itself. *Arnold*, 678 A.2d at 539.

356. *Arnold*, 650 A.2d at 1277.

357. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

358. See *Stroud*, 606 A.2d at 89 (discussing the need to "balance the board's duty to disclose all available material information in connection with the contemplated shareholder vote against its concomitant duty to protect the corporate enterprise," and holding that a board might permissibly withhold "material confidential information from shareholders, who having been given notice and opportunity, failed to execute a reasonable confidentiality agreement").

preclude director damages liability for nondisclosure of even material information.

Fiduciary analysis suggests another potential limit to the recommendation duty of disclosure. Since that duty is premised upon the recommendation by directors who have an informational advantage over dispersed, disaggregated stockholders who necessarily rely on the directors' superior informational resources, it is necessary to examine, particularly in the case of a closely held company, whether and to what extent that informational advantage truly exists. A stockholder may at times have information, or at least access to information, equivalent to that of the board of directors.[359] Where the informational advantage does not exist, the rationale for application of a fiduciary recommendation disclosure duty vanishes.

Finally, fiduciary analysis suggests why the recommendation disclosure duty should not have been considered applicable to the directors in *Stroud* at all. What sets up the fiduciary duty is the reliance by stockholders upon the directors in regard to the latter's recommendation of an act that ultimately rests on the volition of the stockholders. Where that potential for stockholder volition is absent or necessarily irrelevant to determining the outcome of events—as in *Stroud*, where the challenged charter amendments would have been adopted in any event on the strength of the majority block of stock owned by the directors—there is simply no occasion for reliance by stockholders on the directors' recommendation, and no reason to apply a fiduciary recommendation disclosure duty.[360]

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359. Such access may be derived not only from an active management role, but also from exercised contractual rights to information, such as a right under a stockholders' agreement to attend board meetings, consult with officers, or the like.

360. See *Abajian v. Kennedy*, 18 Del. J. Corp. L. 179, 191-92 (Del. Chanc. 1992); *In re USA Cafes, L.P. Litigation*, 600 A.2d 43, 54 (Del. Chanc. 1991) (dismissing "state law breach of duty of candor claims" because "[n]either plaintiffs nor any class member could have been injured by the alleged [disclosure] defect as they had neither a right to vote nor a right to dissent and seek appraisal"); *Glinert*, 16 Del. J. Corp. L. at 784 ("Warrant holders who have no role in approving [a] transaction have no right arising from fiduciary duties to demand disclosure, complete or otherwise [relating to that transaction]."). See also *Virginia Bankshares*, 501 U.S. at 1099-1108 (holding that where votes of minority stockholders were not necessary to effect a freeze-out merger, the proxy statement was not an "essential link in the accomplishment of the transaction," so no private right of action under section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), was available) (citing *Mills*, 396 U.S. at 385 n.7); *Thouret v. Hudner*, 1995-1996 Fed. Secur. L. Rptr. (CCH) ¶ 99,037 (S.D.N.Y. Jan. 30, 1996) (holding that there is no private right of action under § 14(a) of the Securities Exchange Act, where minority stockholder votes were "totally unnecessary and irrelevant to the passage of the directors' proposal for the election of directors at the annual shareholders' meeting," and distinguishing cases where "minority shareholders have given up state law remedies, such as appraisal rights, as a result of false and misleading statements contained in a proxy statement"); Christopher Money, Note, Virginia Bankshares v. Sandberg*: Should Minority Approval Be Required By Law or Corporate Bylaw?*, 37 Ariz. L. Rev. 913, 923-25 (1995). But see Jesse A. Finkelstein, *The Potential*

3. Does the Recommendation Disclosure Duty Affirmatively Require Disclosure of Material Facts, or Merely Avoidance of Material Misrepresentation or Omission?

One must observe preliminarily, again, that this question is largely academic in regard to publicly held companies, since federal law prescribes extensive affirmative disclosure obligations when directors make recommendations in the form of proxy statements or responses to tender offers.[361] As observed in regard to duty of loyalty cases involving public companies,[362] then, the claims in the recommendation disclosure duty area have involved questions of material omission.[363] In this regard, at least, the law of fiduciary duty does little more than what the law of torts accomplishes. It imposes upon the director, when making a recommendation for stockholder action, a duty to use reasonable care to avoid the disclosure of false information and to disclose to the stockholders information necessary to prevent a partial or ambiguous statement from being materially misleading.[364]

Implications of Virginia Bankshares *for Delaware Law*, in 6 *Insights* 28 (May 1992) (noting that when a shareholder vote is sought although not required or needed, directors "[a]rguably . . . may be bound to solicit stockholder approval consistent with the standards that would apply had they been required to seek a vote").

Again, it must be observed that under Delaware law the adoption of charter amendments in *Stroud* did not afford any appraisal remedy to the stockholders, and thus did not present them with any choice of actions in regard to which they could have relied upon the information supplied by the directers in relation to the charter amendment proposals. Where an efficacious choice exists—where there is an appraisal remedy, or where the controlling stockholder group structures the transaction to require the separate approval of a majority of the minority stockholders—the rationale for the recommendation disclosure duty reappears and justifies imposition of the duty. See note 193.

361. See 17 C.F.R. §§ 240.14a-3, .14e-2.

362. See notes 279, 316.

363. See, for example, *Arnold*, 650 A.2d at 1270; *Zirn*, 621 A.2d at 773; *Weinberger v. Rio Grande Industries*, 519 A.2d at 116.

364. Restatement (Second) of Torts § 551(2)(b) (1977) provides in relevant part:

> One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated . . . .
>
> (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement from being misleading.

In addition, Restatement (Second) of Torts § 552(1) provides:

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

The fiduciary recommendation disclosure duty simply extends the obligation prescribed in section 551(2)(b) by applying it to directors who are not a party to the business transaction to which their recommendation relates. The "pecuniary interest" element of section 552(1) should be considered applicable to director recommendations of stockholder action. "The fact that the information is given in the course of the defendant's business, profession or employment is a

The academically—and on rare occasion, as in *Stroud*, practically—more interesting question is whether the fiduciary recommendation disclosure duty is inherently affirmative as well, requiring directors to disclose information material to the recommendation regardless of whether some independent body of law, like the federal securities laws, requires such disclosure. Fiduciary theory suggests that the duty is indeed affirmative. The fiduciary duty and relationship exist because the directors, entrusted with authority over and responsibility for the handling of material corporate information, recommend a course of action or inaction to stockholders who as a result reasonably rely on the directors in making their decision. A rule that eliminated affirmative fiduciary disclosure obligations altogether would, in the absence of some independently derived affirmative disclosure duty, leave disaggregated and non-managing stockholders with the responsibility either to vote or otherwise act in the dark, or gather pertinent information themselves. The outcome of either choice could not be considered efficient. Clearly, the efficient approach is for those who are charged with management responsibility and who make the recommendation in question to provide what material information they reasonably can to the stockholders in connection with their decision.[365]

4. What Are the Remedies for Breach of the Disclosure Duty?

If there is an area in which the developing law of fiduciary disclosure duty is in particular need of restraint, it is in regard to the identification of remedies available for failure to fulfill the recommendation disclosure duty. In *Arnold*, the Delaware Supreme Court made great progress in clarifying that exculpatory charter provisions can preclude an award of monetary damages as a remedy for disinterested

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sufficient indication that he has a pecuniary interest in it, even though he receives no consideration for it at the time." Id. § 552 cmt. d.

Although the Restatement's formulation of negligent misrepresentation doctrine literally addresses only a person who "supplies false information," id. § 552(1), the doctrine has been extended to reach misleading omissions of material facts. See *University of Illinois v. First American National Bank of Nashville*, 1989 U.S. Dist. LEXIS 9525, *8-9 (N.D. Ill. Aug. 7, 1989); *Gale v. Value Line, Inc.*, 640 F. Supp. 967, 971 n.5 (D.R.I. 1986); *Amtruck Factors v. International Forest Products*, 59 Wash. App. 8, 795 P.2d 742, 747 (1990). But see *Ames v. Uranus, Inc.*, 1994 U.S. Dist. LEXIS 12639, *49 (D. Kan. Aug. 24, 1994) (false statement required); *In re Convergent Technologies Securities Litigation*, 721 F. Supp. 1133, 1139 n.4 (N.D. Cal. 1988), aff'd, 948 F.2d 507 (9th Cir. 1991); *Mirkin v. Wasserman*, 12 Cal. App. 4th 927, 937 n.11 (Cal. Ct. App. 1991), aff'd, 858 P.2d 568 (Cal. 1993).

365. See note 260.

breach of the recommendation disclosure duty.[366] More progress, however, should be made.

The analysis of remedies should proceed flexibly and with attention to variation in the social interests at stake in the diverse contexts in which directors' disclosure duties have been identified.[367] It may be useful to place upon directors, as central repositories and managers of corporate information, the duty to gather and present material information when they recommend action to the stockholders. To impose too high a cost and risk upon directors discharging that responsibility, however, would be counterproductive.[368] A disinterested director cannot be an insurer that all material information is presented, any more than a disinterested director can be expected to insure that a managerial decision will not lead to loss to the corporation.[369]

Holding a disinterested director strictly liable in damages for a failure, revealed as such only with hindsight, to disclose a material fact in connection with a recommendation to stockholders has but one conceivable precedential underpinning: *Smith v. Van Gorkom*.[370] This Article argues, however, that if *Van Gorkom* is construed to impose upon disinterested directors personal liability for damages for a non-negligent failure to disclose material facts, it is an "outlier,"[371] and that such liability is insupportable in fiduciary theory. Indeed, under the federal proxy regulations, adopted to promote disclosure of material facts as an independent legislative objective,[372] damages liability must be predicated upon some showing of culpability.[373] Even under the law of trusts—which is surely at least, if not more, demanding than the law of corporate director fiduciary duties[374]—a trustee, even if he *ought* to perform a certain function in acting as trustee, is not

366. *Arnold*, 650 A.2d at 1286-88.

367. Weinrib, 25 U. Toronto L. J. at 20 (cited in note 250).

368. Frankel, *Fiduciary Relationships* at 833 (cited in note 250) (citing *Goodwin*, 186 N.E. at 659).

369. See, for example, *Pollitz v. Wabash R.R. Co.*, 207 N.Y. 113, 100 N.E. 721, 724 (N.Y. 1912) (directors' exercise of their powers over "[q]uestions of policy and management . . . for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient"); Block, *Business Judgement Rule* at 5-11 (cited in note 30) (citing cases).

370. 488 A.2d at 858.

371. Easterbrook and Fischel, *Economic Structure* at 107 (cited in note 3) (suggesting, in discussing the duty of care aspect of the case, that "[i]f *Van Gorkom* is a more traditional business judgment case, it is an outlier").

372. See note 15.

373. See note 16.

374. See, for example, *Cinerama*, 663 A.2d at 1148 ("[T]he corporate liability rule should certainly be less stringent than that of the trust law.").

liable in damages or subject to surcharge if his failure to perform that function is not the result of lack of reasonable care.[375] Hence, a view that any failure to disclose a material fact necessarily requires a remedy in damages is simply too dogmatic and inflexible to be sustained.[376]

These introductory thoughts suggest what remedies *can* be considered appropriate for a failure to fulfill the fiduciary recommendation disclosure duty. First, proof of such a failure before the stockholder action is taken may justify a preliminary injunction, subject to ordinary equitable considerations such as the threat of countervailing harm from granting the injunction, and narrowly tailored to secure corrective disclosure.[377] Second, if equitable considerations warrant, proof of such a failure even after the stockholder action is taken could justify rescission of that action—although intervening rights, particularly in the case of sales of stock to a third party or the mingling of assets following a merger, may frequently make rescission impossible as a practical matter.[378] Indeed, in an appropriate case, rescission of

375. *In re New York, New Haven & Hartford R.R. Co.*, 567 F.2d 166, 179 (2d Cir. 1977) ("A basic tenet of trust law is that '[o]rdinarily a trustee does not commit a breach of trust if he does not intentionally or negligently do what he ought not to do or fail to do what he ought to do'.... The element of voluntariness is critical.") (citation omitted); *Jennings v. Murdock*, 220 Kan. 182, 553 P.2d 846, 871 (Kan. 1976); Scott and Fratcher, *Law of Trusts* § 201 at 219 (cited in note 49) (same).

The duty of a trustee to disclose material information to the beneficiary has been discussed in quite a few cases, but in none of those cases has a disinterested trustee been surcharged, or held liable in damages, for a non-negligent failure to make disclosure. See note 188.

376. It has been suggested that "[i]n Delaware existing law and policy have evolved into a virtual *per se* rule of damages for breach of the fiduciary duty of disclosure." *Tri-Star*, 634 A.2d at 333. See also *Cinerama*, 663 A.2d at 1176. This suggestion is untenably broad if only because liability in damages for disinterested directors is unjustified in the absence of lack of due care in providing material information to stockholders. It is untenably broad for the additional reason, discussed below, that even upon proof of lack of such care, disinterested director liability in damages depends upon proof of actual loss by the stockholder (or the corporation) seeking to impose such liability. See note 389.

377. This is the approach taken in several of the Delaware cases in which a breach of the fiduciary disclosure duty by disinterested directors has been identified. *Gilmartin*, 18 Del. J. Corp. L. at 281; *Anderson, Clayton*, 519 A.2d at 669; *Lacos Land*, 517 A.2d at 271. See also cases cited in note 152. The Delaware Supreme Court's recent opinion in *Arnold* endorses this approach, noting that stockholders subject to breach of a fiduciary disclosure duty "remain protected by the availablity of injunctive relief," even where money damages cannot be assessed against the breaching directors due to an exculpatory provision in the certificate of incorporation. *Arnold*, 678 A.2d at 542.

378. See *Edelman*, 559 F. Supp. at 1184 (nullifying charter amendment eliminating cumulative voting, due to violations of both federal law (SEC Rule 14a-9, 17 C.F.R. § 240.14a-9) and director fiduciary duty of disclosure). For cases in which the courts have declined to grant rescission due te intervening events rendering the remedy impracticable, see, for example, *Mills v. Electric Auto-Lite Co.*, 1972 Fed. Secur. L. Rptr. (CCH) ¶ 93,354 (N.D. Ill. Jan. 10, 1972), rev'd on other grounds, 552 F.2d 1239 (7th Cir.); *Lynch*, 429 A.2d at 501; *Smith v. Shell Petroleum*, 1990 Fed. Secur. L. Rptr. (CCH) ¶ 95,316, at 96,497-98 (Del. Chanc. June 19, 1990).

an election of directors might be warranted, although experience with common law regulation of proxy contests[379] suggests that such relief is likely to be rare indeed. Courts are likely to demand a greater than usual showing of materiality, *i.e.*, proof of a likelihood that the election was affected by the nondisclosures at issue,[380] since (1) election contestants presumably identify and point out their opponent's most significant misstatements or omissions;[381] and (2) there is usually only a relatively short time before the stockholders will have another opportunity, at the following annual meeting of stockholders, to vote again.[382]

A third potential remedy, money damages, may be appropriate *post hoc*, but only where the disclosure shortcoming is attributable to the requisite director negligence, and subject further to preclusion by charter provision, where authorized.[383] Moreover, since the fiduciary theory upon which the recommendation duty of disclosure rests is equivalent in substance to the basis for liability in tort for negligent misrepresentation, two further limitations on the reach of any potential damages claim emerge: (1) damages are limited to loss actually suffered, and do not extend, in this disinterested context, to "rescissory" damages; and (2) damages can be awarded only upon a showing of reliance, that is, that the nondisclosure proximately caused the action giving rise to the stockholders' loss.[384] This Article

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379. See Part II.B.

380. See cases cited in note 90. See also *Loudon*, 1996 Del. Chanc. LEXIS 12 at *8-11 (refusing to employ the Delaware election review statute (8 Del. Code Ann. § 225) to invalidate an election of directors, in the absence of any competing claimants to the directorships at issue, based solely on alleged omissions in proxy solicitation materials).

381. *Bresnick*, 175 F. Supp. at 725; *In re Seminole Oil & Gas Corp.*, 150 A.2d 20, 23 (Del. Chanc. 1959) ("Where, as here, the conflicting claims and answers were presented to the stockholders at length, I think that is a factor which militates against the ordering of a complete resolicitation."); *Goldfield Corp.*, 327 N.Y.S.2d at 335.

382. Even so, courts have on rare occasions invoked state law disclosure duties to require a new election of directors or other stockholder vote. See, for example, *American Hide*, 127 A. at 659; *In re Scheuer*, 59 N.Y.S.2d at 500; *Wyatt*, 59 N.Y.S.2d at 502; *Lieferant v. Bartell*, 232 N.Y.S.2d 1003 (N.Y. Sup. Ct. 1962).

383. See *Arnold*, 650 A.2d at 1286-88 (construing a charter provision adopted pursuant to 8 Del. Code Ann., § 102(b)(7)).

384. This two-part proposition follows from the analogy to principles of negligent misrepresentation, discussed in text accompanying notes 350-52. See, for example, *Wolf v. Magness Construction Co.*, 1995 Del. Chanc. LEXIS 122, *4 (Sep. 11, 1995), aff'd, 676 A.2d 905 (Del. 1996) (requiring "pecuniary loss caused by justifiable reliance upon the false information"); *Glosser v. Cellcor Inc.*, 20 Del. J. Corp. L. 341, 380-81 (1995) (citing Restatement (Second) of Torts § 552 (1977)). With respect to the causation requirement, see also *McNair v. Capital Electric Power Assoc.*, 324 So.2d 234 (Miss. 1975) (finding no showing that nondisclosure by trustees affected the vote of nonprofit cooperative members on a merger proposal).

The concepts of reliance and causation in the disinterested recommendation context bear further explanation. They are relatively easy to grasp where the stockholder action alleged to have been harmful is the sale of shares, as in response to a tender offer. In that situation, contends, therefore, that any "virtual *per se* rule of damages for breach of the fiduciary duty of disclosure" must be limited to the context where it was first identified, namely a transaction assumed to involve self-dealing by a controlling stockholder.[385] No such rule can plausibly be said to exist for breach of a disinterested recommendation duty of disclosure. Any view that tort principles requiring proof of pecuniary loss do not apply to claims of breach of fiduciary duty by disinterested directors must be viewed as out of step with fundamental fiduciary principles.[386]

This outline of potential remedies inevitably prompts resort to the maxim that equity will not suffer a wrong without a remedy.[387] It might be argued, after all, even acknowledging director disinterest and due care, that a failure to disclose a material fact, as required by the fiduciary recommendation disclosure duty, cannot go unremedied simply because that failure is only identified by the court after it has become too late to grant preliminary injunctive relief or rescission.[388] This argument, however, misconceives the nature of the fiduciary duty in question. The "wrong" does not exist solely by virtue of a failure to disclose a material fact. In the absence of lack of care in gathering and presenting material information, there simply is no

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stockholders who do not sell are in no position to complain that they relied on a nondisclosure by directors in their Schedule 14D-9; only stockholders who do sell can make that claim. *Abajian v. Kennedy*, 18 Del. J. Corp. L. at 191-92.

The issues are more complex where reliance is collective, as where all shares are converted in a merger but not all stockholders vote in favor of the merger. In that context, even a stockholder who did not voto in favor of the merger, but whose shares are claimed to be underpaid for in the merger, can claim his harm to have been caused by the disclosure failure, if that failure can be shown to have brought about the necessary vote of the other stockholders. Id. (citing *Freedman v. Restaurant Associates Industries, Inc.*, 16 Del. J. Corp. L. 1462, 1476-77 (1991)). See also *Edelman*, 559 F. Supp. at 1185 (plaintiff stockholder has standing to seek invalidation of charter amendment eliminating right to cumulative voting, even though plaintiff did not vote in favor of the amendment).

385. *Tri-Star*, 634 A.2d at 333.

386. Compare *Cede & Co.*, 634 A.2d at 370-71 ("The tort principles of *Barnes* [*v. Andrews*, 298 F. 614 (S.D.N.Y. 1924) (Hand, J.)], have no place in a business judgment rule standard of review analysis.") with *Frankel v. Slotkin*, 984 F.2d at 1336-37 ("Breach of fiduciary obligation is a tort claim, and thus requires the showing of a duty, a breach, an injury, and causation."); *ALI Principles* §§ 4.01(d), 7.18 (cited in note 32).

387. See, for example, John Norton Pomeroy, *A Treatise on Equity Jurisprudence as Administered in the United States of America* § 423 (Bancroft-Whitney, Spencer W. Symons, ed., 5th ed. 1941).

388. Precisely this plea was made by plaintiff on remand in *Arnold v. Society for Savings*, 1995 Del. Chanc. LEXIS 86, *4, *25 (June 15, 1995), aff'd, 678 A.2d 533 (Del. 1995). Acknowledging that "it is often thought to be axiomatic that a wrong must have a correlative remedy," the Delaware Supreme Court recognized that "this is not always the case." 678 A.2d at 541. The court reasoned that loss of potential remedies, due either to passage of time or stockholder action approving elimination of director monetary liability, cannot force the creation of some unprecedented damages remedy against the corporation itself.

fiduciary "wrong" in this context at all.[389] If it seems incongruous, then, that a preliminary injunction could be granted to permit curative disclosure despite director disinterest and due care, one can look at the case law to see that federal courts have long acknowledged that a plaintiff may seek injunctive relief to cure a disclosure failure, while denying to that same plaintiff a damages remedy for the same disclosure failure.[390] Any superficial lack of logic in this approach is amply offset by a practical appreciation of the relative intrusiveness of the preliminary injunction remedy as compared to the post hoc damages remedy.

E. Other Public Statements by Corporate Fiduciaries

Finally, fiduciary theory illuminates the last area in which a fiduciary disclosure duty has been suggested: public statements not intended on their face to elicit or counsel stockholder action. In this context, this Article contends, there is no fiduciary relation at stake at all. At most, directors and officers who issue press releases or other public corporate statements have the market generally, and not the stockholders, as ordinarily intended objects or beneficiaries of the information.[391] The directors have no recognized function under state

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389. Thus, it is not merely the stockholders' adoption of an exculpatory charter provision that left them without a remedy in *Arnold*, as the court there suggested. 678 A.2d at 542. In fact, that suggestion unnecessarily intimates that the stockholders would have *had* a damages remedy against the disinterested directors of Society for Savings but for the exculpatery provision.

390. For example, in evaluating issues of standing or the existence of a private right of action under the federal securities laws, the courts have considered the policies of those laws to confer standing upon a tender offeror to seek injunctive relief to cure a disclosure violation, while denying the offeror standing to pursue a claim for damages based upon such a violation. Compare *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 42 n.33 (1977) (denying offeror standing to seek damages in respect of a violation of section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e)), with *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 371-73 (6th Cir. 1981) (allowing a tonder offeror standing to seek injunctive relief against conduct in violation of section 14(e)).

Similarly, and even more to the present point, federal courts interpreting implied rights of action under the proxy rules have differentiated the culpability requirements for relief, depending upon whether the relief sought is an injunction or damages. See *Ash v. LFE Corp.*, 525 F.2d 215, 220 (3d Cir. 1975) ("Whatover may be the rule with respect to scienter where other remedies such as damages or rescission of a sale are sought, we have no hesitancy in recognizing that for prospective relief looking to the protection of the franchise the test for the purposes of Rule 14a-9 is the objective sufficiency of the disclosure."); *Calumet Industries, Inc. v. MacClure*, 464 F. Supp. 19, 28 (N.D. Ill. 1978).

391. Stock exchange rules require that listed companies publicly disseminato current information of material significance to investors. See, for example, *NYSE Listed Company Manual* ¶ 202.05, reprinted in 3 Fed. Secur. L. Rptr. (CCH) ¶ 23,519 at 17,214:

> A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities.

corporate law to manage information so that one segment of the market, existing stockholders, can make buy/sell or other stock-related decisions more intelligently than nonstockholders. Nothing in the law sets up directors as objects of stockholder reliance or sources of recommendations to stockholders, from which an all-encompassing fiduciary duty of continuous disclosure might be inferred. To the contrary, to the extent that law or stock exchange rules require public disclosure where stockholder action is not sought, the regulatory goal is market regulation and enhancement, not oversight of the director/stockholder relationship.[392]

There is certainly no basis to quarrel with the application of conventional tort doctrine to public statements made by directors, or by anyone else for that matter. A knowingly incorrect statement or misrepresentation by omission constitutes an actionable wrong where it is detrimentally relied upon by a stockholder or anyone else foreseeably affected by it.[393] To create a fiduciary duty to stockholders in this context, however—and it *would* be creating one[394]—would signifi-

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> This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.

See also *American Stock Exchange Guide* § 402(a), reprinted in 3 Fed. Secur. L. Rptr. (CCH) ¶ 23,124A, at 17,098; *NASD Manual*, By-Laws Schedule D, Part 2, § (c)(15) (CCH) ¶ 1803 at 1566 (1991).

To be sure, there may be occasions on which the directors do intend to influence stockholder action by the content of a press release. *Marhart* clearly involved a suggestion of such behavior, and as that case shows, dissemination of false information intended to induce existing stockholders, to their detriment, to retain their stock, will support a claim of common law fraud. *Marhart*, 18 Del. J. Corp. L. at 337.

392. See 15 U.S.C. § 78f(b)(5) (conditioning stock exchange registration upon adoption of exchange rules "designed to . . . perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest . . ."); Brown, *Corporate Disclosures* § 3.06[1] at 3-64 (cited in note 22).

393. Restatement (Second) of Torts §§ 526, 529, 534 & cmt. c, 537, 548 (1977).

394. In its July 25, 1996 opinion in *Kahn v. Roberts*, the Delaware Supreme Court declined to adopt the court of chancery's ruling that no such fiduciary disclosure duty exists, and it cautioned that "this court has never stated that full disclosure is required *only* when seeking shareholder action." 1996 Del. LEXIS 275, *20 (emphasis in original). The court noted that the "court of chancery has not spoken with a unified voice on this question." Id. at n.7. The court's observation of disunity was correct. The balance of precedent, however, weighs against the creation of a fiduciary disclosure duty universally acceptable to all public corporate disclosures regardless of context, scope of dissemination, or purpose. See *First Eastern Corp. v. Mainwaring*, 1992 U.S. Dist. LEXIS 16979, *20-21 (E.D. Pa. Nov. 4, 1992) (granting partial dismissal, finding no director fiduciary "duty of candor" under Pennsylvania law in respect of allegedly false or misleading statements in periodic reports); *Uni-Marts, Inc. v. Stein*, 1996 Del. Chanc. LEXIS 95, *21 (Aug. 9, 1996) ("[F]iduciary liability for misdisclosure requires that the material misstatement or omission by a fiduciary be in connection with the soliciation of shareholder action, such as tender, a vote, a consent or a withholding of the same."); *Kahn v. Roberts*, 1995 Del. Chanc. LEXIS 151, *21 (Dec. 6, 1995) ("Delaware law does not require a Board to divulge material developments with respect to the company's business if the board does not seek the vote of the shareholders."), aff'd on other grounds, 1996 Del. LEXIS 275 (July 25, 1996); *Bragger v. Budacz*, 1994 Del. Chanc. LEXIS 202, *14 (Dec. 7, 1994) (since spin-off

cantly rewrite the corporate contract, effectively substituting state law for what is historically and far more properly a federal matter: the regulation of disclosure in the interest of facilitating interstate markets for securities.[395]

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information statement "did not seek any shareholder action . . . a fiduciary obligation of full disclosure is not implicated"); *Herd v. Major Realty Corp.*, 1990-1991 Fed. Secur. L. Rptr. (CCH) ¶ 95,772, at 98,718 n.2 (dismissing claims based on press releases and a Form 10K because "the duty of candor requires disclosure of all material facts only in connection with a transaction on which stockholders are asked to vote"). See also *Levy v. Stern*, 1996 Del. Chanc. LEXIS 25, *1 (Mar. 12, 1996) (noting the inconsistoncy between *Marhart* and *Kahn*, but granting summary judgment to defendants instead based on exculpatery charter provision).

Of the cases cited by the Delaware Supreme Court in *Kahn*, *Marhart* is clearly the only direct source of precedent for the establishment of a fiduciary duty of disclosure outside the transaction context. The earlier suggestion of such a duty in *In re Rexene Corp. Shareholders Litigation*, 1991 Fed. Secur. L. Rptr. (CCH) ¶ 96,010, at 90,059 n.1 (Del. Chanc. May 8, 1991), aff'd, 604 A.2d 416 (Del. 1991), and the subsequent reiteration of *Marhart*'s holding in *Ciro, Inc. v. Gold*, 816 F. Supp. at 266, were both dictum. An earlier order in *Levy v. Stern* denied a motion to dismiss a claim of material omissions of adverse information where no stockholder action was sought and plaintiffs sold no shares, but it too relied on *Marhart*. 1996 Del. Chanc. LEXIS 25 at *3-4. *Freedman v. Restaurant Associates Indus., Inc.*, 1990-1991 Fed. Secur. L. Rptr. (CCH) ¶ 95,617, at 97,882 (Del. Chanc. Sept. 19, 1990, revised Sept. 21, 1990), involved a tender offer by a management group, a circumstance in which fiduciary duties are commonly recognized. See Part III.A. The irrelevance of *Kelly v. Bell* has already been noted. See notes 69 and 85. In *Kahn v. Roberts*, 1994 WL 70118 (Del. Chanc. Feb. 28, 1994), the court denied a motion to dismiss a putative class claim of material omission in a letter to stockholders describing the reasons for a repurchase of stock. That ruling rested on the broad proposition that "directors who decide voluntarily to disclose information to stockholders are subject to the duty of full and frank disclosure of all material facts," and relied solely on *Marhart* and *Kelly*. At least in *Kahn*, the communication at issue was one specifically directed to the steckholders, rather than to the market generally, and could more plausibly engender reliance by the stockholders as a distinct group. In all events, the subsequent opinion in *Kahn*, granting a defense motion for summary judgment, follows the reasoning of *Raskin* and *Herd*. See also *Capital Real Estate Investors Tax Exempt Fund Limited Partnership v. Schwartzberg*, 929 F. Supp. 105, 116 (S.D.N.Y. 1996) (noting, only for purposes of evaluating defendants' propensity to violate the securities laws in the future, that the failure of press releases to disclose general partners' conflict of interest in proposed mergers of limited partnerships "almost certainly violated state fiduciary duties requiring full disclosure," even if the press releases were not deemed to have been a "solicitation" under SEC Rule 14a-1).

395. See *Arnold*, 678 A.2d at 539 (declining to "replicate, by state decisional law, the provisions of section 14 of the 1934 Act," since "[s]uch a result would represent a significant change to the existing matrix of duties which governs the relationship among stockholders, directors and corporations"). See also *Uni-Marts*, 1996 Del. Chanc. LEXIS 95 at *22 (stating that the rule in *Marhart* "would open state courts under the fiduciary duty rubric to the regulation of all market transactions in an issuer's stock by public shareholders whenever a shareholder traded after a public announcement (or failure to announce?) by a corporate officer. A respect for the evolved roles of state regulation of internal corporate affairs and federal regulation of securities markets counsels against such a radical result"); Roger J. Dennis and Patrick J. Ryan, *State Corporate and Federal Securities Law: Dual Regulation in a Federal System*, 22 Publius: The J. of Federalism 21 (Winter 1992) (urging continuity of the roles historically played by both state and federal law in regulating corporate governance and disclosure). Indeed, given *Marhart*'s falsity, scienter, reliance, and loss requirements, the only real consequence of its characterizing the disclosure duty as fiduciary in nature is to permit the Delaware state courts to entertain, as assertions of breach of fiduciary duty, claims that would otherwise be brought as Rule 10b-5 claims or common law fraud claims in other courts. See *Marhart*, 18 Del. J. Corp. L. at 336; notes 396-97.

This approach in no way leaves stockholders unprotected against public misrepresentations by management; it simply leaves such protection a matter addressed by other bodies of law. A viable claim under the knowing misrepresentation fiduciary theory suggested in *Marhart* would ordinarily support a damages claim under Rule 10b-5,[396] and for a class that included all purchasers or sellers, and not just stockholders at the time of the challenged nondisclosure.[397] The only persons for whom the *Marhart* fiduciary duty theory could afford a basis for recovery not available under Rule 10b-5 are those who were stockholders at the time of the material nondisclosure and who claim that they would have bought more shares, or sold their shares, but for the material nondisclosure. Yet to allow recovery of damages by such persons would run squarely afoul of the problems of speculative proof that persuaded the United States Supreme Court to impose a purchaser/seller requirement in damages actions under Rule 10b-5.[398]

It is only partly reassuring that *Marhart* only applies a duty of completeness, and does not purport to create an affirmative duty of disclosure.[399] Limiting the fiduciary duty identified in *Marhart* to a duty of completeness, however, seems artificial. If a fiduciary duty exists to ensure that disclosures made by management to the general public are sufficient to inform the stockholders fully in their decisions to buy or sell shares in the market, then, as has been suggested with some force, it "does not follow analytically" to limit that duty to one of completeness, rather than extend it to require affirmative disclosures.[400] Yet to require affirmative disclosures in lieu of silence would take the courts into areas of state law into which, at least thus far, they have consistently declined to go.[401] At the very least, such a step should proceed from a firm basis in fiduciary principles. No such basis, however, has been suggested.

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396. 17 C.F.R. § 240.10b-5. See, for example, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). State securities statutes may also support such a claim. See, for example, *Rosenthal v. Dean Witter Reynolds, Inc.*, 908 P.2d 1095 (Colo. 1995).

397. See Arnold S. Jacobs, 5B *Litigation and Practice Under Rule 10b-5* § 62 at 3-304 (Clark Boardman, 2d ed. rev. ed. 1992).

398. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 745-47 (1975).

399. *Marhart*, 18 Del. J. Corp. L. at 335.

400. Brown, *Corporate Disclosure* § 9.04 at 9-29 (cited in note 22).

401. See, for example, *Washington Bancorporation v. Said*, 812 F. Supp. 1256, 1271 (D.D.C. 1993); *First Eastern Corp. v. Mainwaring*, 1992 U.S. Dist. LEXIS 16979 (E.D. Pa. Nov. 4, 1992); *Raskin*, 1990-1991 Fed. Secur. L. Rptr. ¶ 95,668; *Herd*, 1990-1991 Fed. Sec. L. Rep. ¶ 95,772; *Lindner Fund, Inc. v. Waldbaum, Inc.*, 604 N.Y.S. 2d 32, 624 N.E.2d 160, 161 (N.Y. 1993) (dismissing a claim that fiduciary duty to steckholders required disclosure of a takeover agreement in principle).

Marhart, then, was a toe unnecessarily dipped in very deep, murky legal waters in which state fiduciary doctrine had never previously swum. Enthusiasm for the moral obligations of corporate fiduciaries should not obscure the radical character of that jurisprudential step. This Article contends that the law of fiduciary disclosure duty should remain solidly footed in its traditional contexts outlined above.

VI. RECAPITULATION

Scattered judicial and scholarly treatment has left the disclosure obligations of corporate fiduciaries unsettled, the occasional victim of a judicial willingness to follow the exhortations of fiduciary rhetoric into contexts in which the rationales of fiduciary obligation do not support the existence of such a duty or the remedies suggested for breach of such a duty. A reconsideration of the historical and varied contexts of fiduciary disclosure duties and an examination of how those contexts largely dovetail with generally accepted rationales of fiduciary doctrine should contribute to a more precise and justifiable development and application of fiduciary disclosure duties in future cases.

Where the fiduciary rationales operate most vigorously and appropriately—that is, where corporate directors seek stockholder action approving or effecting transactions in which the directors' conflicting personal interests are served—the courts have appropriately imposed affirmative fiduciary disclosure obligations and backed them up with the broadest range of equitable remedies. Where directors are disinterested and merely serve a recommendation function, an affirmative disclosure duty akin to the duty of care and the tort of negligent misrepresentation exists to help assure that stockholders are provided with corporate information material to the recommendation. The remedies for breach of that duty, however, are constrained in the same way as the remedies for breach of the traditional duty of care, or the analytically equivalent tort duty to avoid negligent misrepresentation. The damages remedy is limited to cases of director neglect and to losses actually incurred by stockholders in reliance on the disclosure failure. Finally, where disinterested directors fail to disclose information that is material to the market generally, but not to any recommendation made to the stockholders by the directors, there is no fiduciary rationale that warrants imposition of a fiduciary disclosure duty for the benefit of the portion of the market that happens to own stock already.

From these considerations, future development of the case law, particularly in Delaware, could be clarified and improved by:

- Clear recognition of the context—self-dealing versus disinterested; recommending stockholder action or merely providing information to the market generally—in which the fiduciary disclosure duty is invoked;
- Recognition that when disinterested directors recommend stockholder action, they can be held personally liable in damages for a failure to disclose a material fact to stockholders *only* where that failure is the product of culpable negligence in gathering and presenting information to stockholders;
- Recognition that, as under the doctrine of negligent misrepresentation, stockholders may not recover damages from disinterested directors, based on a claimed nondisclosure in connection with a director recommendation of stockholder action, unless the stockholders can establish reliance upon the claimed nondisclosure; and
- Recognition that in claims against disinterested directors of a material nondisclosure in connection with a recommendation of stockholder action, there is no *per se* rule of damages, and recovery of damages depends upon proof of actual loss.

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