LIFT NOT THE PAINTED VEIL! TO WHOM ARE DIRECTORS' DUTIES REALLY OWED?

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In this Article, we identify a fundamental contradiction in the law of fiduciary duty of corporate directors across jurisdictions, namely the tension between the uniformity of directors' duties and the heterogeneity of directors themselves. American scholars tend to think of the board as a group of individuals elected by shareholders, even though it is widely acknowledged (and criticized) that the board is often a largely self-perpetuating body whose inside members dominate the selection of their future colleagues and eventual successors. This characterization, however, is far from a universal international truth, and it tends to be increasingly less true, even in the United States. Directors are often formally or informally selected by specific shareholders (such as a venture capitalist or an important shareholder) or other stakeholders of the corporation (such as creditors or employees), or they are elected to represent specific types of shareholders (e.g., minority investors). The law thus sometimes facilitates the nomination of what has been called "constituency" directors. Once in office, legal rules tend to nevertheless treat directors as a homogeneous group that is expected to pursue a uniform goal. We explore this tension and suggest that it almost seems to rise to the level of hypocrisy: Why do some jurisdictions require employee representatives that are then seemingly not allowed to strongly advocate employee interests? Why can a director representing a specific shareholder not advance that shareholder's interests on the board?

Behavioral research indicates that directors are likely beholden to those who appointed them and will seek to pursue their interests in order to maintain their position in office. We argue that for many de-

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cision making processes, it does not matter all that much what specific interest directors are expected to pursue by the law, given that across jurisdictions, enforcement of the corporate purpose is highly curtailed.

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I. INTRODUCTION

All directors are loyal. Some are more loyal than others, and some are not only loyal to the corporation. By whom and for what purpose are the directors appointed? Whose interests do they represent? Should there be a distinction between the duties of directors proposed by management and elected by shareholders, and those elected upon the proposal of a specific, influential shareholder or creditor to represent her interests?

These questions have historically seldom been raised, even though loyalty and fiduciary duties of directors in general have played a central practical role in U.S. corporate law since at least the 1930s.[1] The situation is similar abroad: while in European jurisdictions enforcement through shareholder litigation traditionally has been rarer than in the United States, the duties of directors and their close equivalents are increasingly considered to be of central significance. Both in the United States and abroad, however, references to directors' duties in the increasing volume of case law remain surprisingly monolithic and rarely consider that directors may legitimately have multiple loyalties. Empirical research remains limited, but it has shed new light on directors' decision-making patterns: behavioral and economic research provides fact-based evidence casting doubt on the reality, as well as the possibility, of homogeneous duties for directors.[2]

Looking at heterogeneity on the board is both timely and an issue of high practical significance given current developments in corporate case law. On the one hand, the Delaware courts have remained faithful to the traditional approach with respect to directors' decisions: In the 2009 case of *In re Trados Shareholder Litigation,* the Court of Chancery refused to grant the benefits of the business judgment rule to the decisions of directors affiliated to a venture capitalist whose interests were at stake in a decision of the board.[3] On the other hand, in the 2013 case of *Kalisman v. Friedman,* Vice Chancellor Travis Laster stated that "[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director."[4] It is not entirely clear whether this statement is consistent with prior case law.[5]

The uniformity of fiduciary duties may be challenged on two grounds: first, the heterogeneity of the beneficiaries to whom the duties are owed, and the expectations of such beneficiaries; and, second, the heterogeneity among directors themselves, and, therefore, the natural loyalty of such directors.

The first source of heterogeneity develops among beneficiaries rather than among directors: it has, however, not given rise to the design of any specific duties for individual directors. On the contrary, there seems to be a cultural and legal universal for jurisdictions to abstain from formulating such differentiated rules. Heterogeneity among directors matches what may be analyzed as a second source of heterogeneity: cor-

1. On the Berle-Dodd debate, *see, e.g.*, William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation,* 34 J. CORP. L. 99, 122–35 (2008).

2. *See infra* Part IV.D.

3. No. 1512-CC, 2009 WL 2225958, at *1 (Del. Ch. July 24, 2009).

4. No. 8447–VLC, 2013 WL 1668205, at *17 (Del. Ch. Apr. 17, 2013).

5. *Contra, e.g.*, Holdgreiwe v. The Nostalgia Network, Inc., No. 12914, 1993 WL 144604 (Del. Ch. Apr. 29, 1993) (suggesting that sharing information with stockholders may violate fiduciary duty).

porate law typically requires directors to be loyal to the corporation and to work for its benefit and success. What exactly this means is not always clear. The debate about the corporate objective typically oscillates between requiring directors to be loyal "to the corporation and its shareholders" (which provides already for two different beneficiaries), and including the interests of other stakeholders, or even the public interest, in this overall goal, which creates yet additional classes of beneficiaries.

In terms of their representative role, we can find so-called "independent" directors on one end of the spectrum: they are by definition expected to shield themselves from all types of partisan influence.[6] On the opposite end, some directors are appointed by stakeholders, or shareholders, who have a specific interest in the manner the company is operated.[7] Venture capitalists will often negotiate the right to appoint a director. Lenders or employees may also be represented on the board. Directors appointed to represent the interest of a designated stakeholder are sometimes called "constituency" directors.[8] The law of many jurisdictions requires or facilitates the appointment or election of various types of these directors to the board. Constituency directors may be expected to support their appointer or nominator while they discharge their duties.[9] How may a director representing the interests of employees not have reservations as to pure profit maximization objectives when tackling corporate policy matters? How may a director nominated by a venture capitalist not pay specific attention to the protection of her patron's investment in the company, or not frame issues with the idea that an exit strategy for the venture capitalist needs to remain available? More specifically, a practical implication may be found in the important question of how constituency directors deal with their sponsors with respect to information. One of the major issues discussed in the recent U.S. literature is whether directors representing venture capitalists should be permitted to share sensitive information with them.[10]

In spite of this, jurisdictions apply the same set of fiduciary duties to all directors across the board, irrespective of how they were elected or appointed. The duty not to prefer your own interests to those of the persons to whom you owe a duty is the same, irrespective of who appointed you. This observed uniformity is, however, surprising and needs to be questioned, keeping in mind a double commercial reality: appointing stakeholders have different expectations, and directors are appointed on a variety of grounds and their levels and types of expertise are different.

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6. For a definition of "Independent director," see NYSE LISTED COMPANY MANUAL, SECTION 303A.02; *NASDAQ Rule 4200a(15)*, U.S. SEC, *available at* https://www.sec.gov/rules/other/nasdaqllcf1a4_5/nasdaqllcamendrules4000.pdf.

7. *See infra* Part II.A.

8. In the United Kingdom, constituency directors are known as "nominee" directors and are sometimes referred to as designated directors or representative directors.

9. We are only looking at directors who are specifically representing stakeholders, and not at independent directors who, by definition, are expected to distance themselves from any particular interest.

10. *Infra* Part V.

May the duties of directors, including constituency directors, nevertheless be thought as being univocal? American corporate lawyers are used to thinking about directors as a relatively homogenous group in terms of how and by whom they are appointed, namely following an election by shareholders, who are strongly influenced by the current administration and board. In comparative perspective, the heterogeneity in the boardroom could hardly be less conspicuous.[11] Germany famously gives half of the seats on the supervisory board of its largest firms to employee representatives,[12] and a number of other countries have other employee participation systems.[13] Some corporate laws permit a stipulation in the corporation's charter for the holders of specific registered shares to appoint certain directors.[14] In the absence of a formal arrangement, large shareholders or even creditors often get to nominate a specific director who is then dutifully elected by the controlling coalition of the firm.[15] Such situations create a potential conflict between duties owed to the appointer and duties owed to the company. In all of these cases, corporate law exhorts directors to pursue the mystifying interest of the corporation instead of pursuing what may appear to an external observer the most obvious course of action, namely to represent their respective constituency. This principle appears from the outset difficult to put into practice. Even if courts affirm the mere fact that a director who has been nominated by certain stakeholders does not impose any duty to benefit such stakeholders, this is an orthodox legal statement that may appear remote from the reality of corporate culture. It appears that the very fact that there is a designated appointer will, in general, create a specific connection between the constituency director and the appointing constituency, typically reinforced by the latter's power not to reappoint the director: "loyalty inspired by selection, and confirmed by the confidence which the appointers repose in their nominees, is reinforced by the appointer's power of dismissal."[16] In addition, does not the very fact that corporate laws require or enable the appointment of directors by specific constituencies indicate that these directors not only represent these groups or individuals in a symbolic sense, but that they are also intended to be knowledgeable about and sympathetic to their interests?

While typically issues such as directors representing venture capitalists and employee representation have been discussed separately, we at-

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11. We will subsequently use the terms "homogeneity" and "heterogeneity" when referring to the individuals serving on the board, and "uniformity" and "diversity" when referring to their duties.

12. *See infra* Part II.A.1.

13. *See id.*

14. *See, e.g.*, *id.*

15. Former Delaware Chief Justice Norman Veasey and Christine Di Guglielmo have called this practice the "constituency director." E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 761 (2008).

16. E.W. Thomas, *The Role of Nominee Directors and the Liability of Their Appointers*, *in* CORPORATE GOVERNANCE AND THE DUTIES OF COMPANY DIRECTORS 148, 150 (Ian Ramsay ed. 1997).

tempt to address these phenomena jointly.[17] On the basis of what was explained above, the uniformity of directors' duties, which is affirmed across jurisdictions, seems somewhat hypocritical. At a minimum, there is a paradox in providing, on the one hand, for directors' nomination rules linked to specific constituencies and, on the other hand, for heterogeneity-blind duties.

The objective of this Article is to explore this tension between the proclaimed uniformity of duties and the inevitable heterogeneity of the individuals on the board. Looking at the law of the United States as well as several key European jurisdictions, we advance two larger claims. First, we suggest that the disjunction between the appointment of directors and fiduciary duties is only sustainable because the purported objective of fiduciary duty—however formulated in theory—is not clearly defined at all. Obscurity conveniently shadows what is an unsettling issue. It is only possible because, across jurisdictions, the fiduciary duties of directors are delineated primarily negatively; in other words, they almost exclusively say what directors must "not do" and in quite broad terms.[18]

Second, we argue that the increasing heterogeneity on the board can be seen as the consequence of a larger trend. Traditionally, U.S. corporate governance has been dominated by managerial capitalism, where a faceless mass of small investors was juxtaposed to a powerful board of directors. In recent years, a more heterogeneous shareholder structure has begun to develop; consequently, there is an increasing population of larger shareholders who want their voices to be heard more explicitly in the boardroom. While U.S. corporate governance is still different—in many ways—from other systems that have employed "constituency directors" more regularly for decades, we can see their increased use as an element of transition from a "variety of corporate capitalism" to a new one that maybe resembles more strongly a coordinated structure than a market-based one. One could thus say that the United States "variety of capitalism" is "undergoing realignment."[19] A greater recognition of a role of individual directors in their relation to their appointer would merely recognize this shift.

There are, however, also more precise, positive corporate objectives to be fulfilled by directors. These objectives are not standardized, but relate to the corporate object of the considered company, its development

17. For a similar synthetic approach, see Deirdre Ahern, *Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy*, 127 L.Q. REV. 118 (2011).

18. *See* Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 909 (2011) ("The fiduciary duty to avoid self-dealing is not defined with reference to the specific parties on whose behalf the fiduciary must act."); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 284 (1998) ("Some applications of the fiduciary principle in corporate law do not require the identification of any particular corporate constituency as beneficiary, but only that the interests of 'the corporation' in general must be served.").

19. True, the U.S. economy had an important corporatist element in the 50s and 60s, namely powerful unions that could be seen as an element of coordinated capitalism in their collective bargain with unions. While the United States has become more market-based in the labor dimension in recent decades, we suggest that it is becoming more "coordinated" in the financial dimension in recent years.

level, and anticipated new milestones. More specifically, what is expected from directors is not so much to lean towards the objective of the corporation and corporate law, but towards the effective corporate objective as it emerges from the boardroom and is recorded in board decisions and periodic reports. To phrase it differently, the duties imposed on directors emerge largely from corporate objectives which are the product of the process of board deliberation:[20] Directors themselves determine the corporate objective to a large extent via their deliberations—and thus the content of the duty of loyalty.[21]

The content of the corporate objective and of the fiduciary duties is, thus, indirectly determined (1) by the factors that influence the appointment of directors and the pressure on information sharing that derives thereof, which is how constituency directors deal with their sponsors with respect to information; and (2) social, cultural, and economic factors that determine how directors come to their decisions.

This Article proceeds as follows: In Part II, we look at the role of constituency directors in business today. To situate our Article in corporate practice, we look at how boards are often very heterogeneous and provide a taxonomy of directors representing specific interests; the law, more so outside the United States, facilitates the appointment or election of *de facto* representatives of specific groups. We suggest that this phenomenon reflects the general structure of a given financial and corporate governance system. With the rise of institutional investors and a possible reconcentration of share ownership, a higher frequency of such directors in the United States is not surprising. Part III then turns to fiduciary duty. We survey debates about the "general objective" directors are expected to pursue; a heterogeneous board may well be linked to a vision

20. *See* Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on* Disney*, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 436 (2007) ("Thanks in large part to the business judgment rule, directors are free to exercise broad discretion when they interpret what the 'best interests of the corporation' are."); Andrew S. Gold, *Dynamic Fiduciary Duties*, 34 CARDOZO L. REV. 491, 493–94 (2012) (discussing the indeterminacy of corporate fiduciary duties and suggesting that directors are allowed to select from within a range of corporate beneficiaries); *see also* Lionel Smith, *The Motive, Not the Deed*, *in* RATIONALIZING PROPERTY, EQUITY AND TRUSTS: ESSAYS IN HONOUR OF EDWARD BURN 53, 70–71 (J. Getzler ed. 2003) (noting that both in the United States and in Commonwealth jurisdictions, courts require directors to act in what they perceive to be the best interest of the corporation, but do not look at its substance).

21. Arguably, in recent years the development of the concept of good faith in the Delaware courts may have reduced this discretion by requiring an affirmative devotion to the fiduciary duty's beneficiaries, thus going beyond the traditional focus of the duty of loyalty on conflicted transactions under *Disney* and *Stone*. Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (explaining the requirement to act in good faith as a "'subsidiary element' . . . 'of the fundamental duty of loyalty'"); *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005) (stating, among others, that a fiduciary may violate the duty of good faith by intentionally acting "with a purpose other than that of advancing the best interests of the corporation"); s*ee* Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 461, 468–70 (2009) (explaining how the requirement to act in good faith expands fiduciary duty); Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 19–21 (2005) (explaining how the duty of good faith, based on a claim that "could not have survived dismissal under either traditional fiduciary duty," went beyond the duties of loyalty and care in the *Disney* decision); Claire A. Hill & Brett H. McDonnell, Stone v. Ritter *and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1780–81 (2007) (discussing types of cases where good faith may play a role).

going beyond homogeneous financial investors with a mere financial interest. Surprisingly, laws in different jurisdictions unanimously assume that all directors, however selected, should pursue only a single goal. Part IV picks up the normative debate by looking at what insights can be gained from the social sciences, in particular economics and psychology, while also taking into consideration the limited empirical evidence. Economic theory would seem to suggest that governance rights may be the best way of dealing with the necessary incompleteness of both legislation and contracts intended to protect investors and other constituencies of the corporation. While permissiveness in terms of how directors are allowed to interpret them may in fact be efficient, behavioral theory and the limited empirical evidence suggest that it may be inevitable for directors to represent particular interests. Building on this, we return to doctrine in Part V. First, we suggest that across jurisdictions, directors' duties hardly intrude on directors' decisions that redistribute between the firms' constituencies, as long as they do not amount to self-dealing. Thus, the discrepancy may not matter all that much because the overall objective of the corporation is not clearly defined or meaningfully enforced by the law. Second, there are significant counterarguments as to sensitive information transfer by individual directors and collective decision making by the board, suggesting that it may be justifiable for directors with conflicted loyalties to share information with their respective constituency. In the end, it appears that the apparent mismatch between uniform duties and heterogeneous personal loyalties may be mostly problematic in connection with the question of how constituency directors may interact with their sponsors, and whether they should be permitted to convey sensitive information to them (we suggest that such should be the default rule). Part VI summarizes and concludes.

II. SETTING THE SCENE: PERSONAL LOYALTIES OF CONSTITUENCY DIRECTORS ACROSS FINANCIAL SYSTEMS

We begin by setting the scene and exploring the changing role of directors. First, we investigate how heterogeneous directors often are today. Besides directors elected by shareholders in the regular way, a whole range of types of constituency directors populate corporate boards in major jurisdictions, apparently to represent diverse interests (Section A). From the perspective of traditional American corporate law theory steeped in the idea of separation of ownership and control, this at first glance may seem unusual or even an aberration. From the days of Berle and Means onwards, large U.S. corporations were characterized by strong management; directors were thus either senior officers of the corporation or their trusted advisors. With the discovery of agency theory and the corporate governance movement, independent directors were added to the mix as a symptom of a shift from managerial to shareholder capitalism. As we suggest in Section B, the presence of directors representing *particular* interests in large firms is rather symptomatic of a third type of economic organization, namely one where different interest groups are represented through "coordinated" bargaining mechanisms outside capital markets.

A. Heterogeneous Personal Loyalties

Most jurisdictions start with the basic rule of the board of a public corporation being elected by shareholders. Shareholders, however, do not all have the same *de facto* power to elect board members, as the corporate charter may provide for a specific seat's repartition. In addition, it is widely acknowledged (and criticized) that the board is often a largely self-perpetuating body, whose inside members dominate the selection of their future colleagues and eventual successors.[22] It may be of interest to observe that the mechanism for such perpetuation is not the same in every jurisdiction.[23] While the classic vision may still accurately describe a certain subset of large, publicly traded corporations even in the United States, one strategy of having directors pursue goals beyond (or beside) those of equity investors, however, is to ensure a heterogeneous composition of the board. More often than in the United States, directors in Continental Europe are appointed through a more diverse set of processes as a practical matter. Hence, there is no direct and simple connection between shareholders' preferences at the time of the nomination and the actual composition of the board. We can distinguish different families of directors with specific nominators corresponding to different allegiances.

1. Labor Representatives

A number of European countries require employee representation on the supervisory board[24] or board of directors. Comparative corporate law scholars often focus on the German example, in which one-third of directors must be employee representatives in firms between five hundred and two thousand employees,[25] and one-half in larger

22. While this is only a factual outcome in the United States, Dutch law actually prescribed a largely self-perpetuating board until 2004 for the largest firms. *See, e.g.*, Edo Groenewald, *Corporate Governance in the Netherlands: From the Verdam Report of 1964 to the Tabaksblat Code of 2003*, 6 EUR. BUS. ORG. L. REV. 291, 294–97 (2005).

23. Most corporate governance systems are characterized by concentrated ownership structures, where a controlling shareholder or coalitions of large shareholders effectively decide who is on the board of directors. Between the two major systems with dispersed ownership—the United States and the United Kingdom—the United States is typically considered board-centric, since various legal and nonlegal mechanisms make it difficult for shareholders to coordinate to exercise any control over the corporation. By contrast, the United Kingdom, while having dispersed ownership as well, has during the past decades been dominated by coalitions of institutional investors that were in the position to step in at least when they were strongly dissatisfied with management.

24. This applies to countries that either require or allow firms to use the two-tier model, in which the executive and monitoring functions are separated into two different corporate bodies, membership in which is incompatible.

25. Drittelbeteiligungsgesetz, May 18, 2004, BGBL. I at 974, last amended by Gesetz, July 30, 2009, BGBL. I. at 2479, § 1 (F.R.G.); *see also Board-Level Representation*, WORKER-

corporations.[26] A number of countries, including Austria,[27] Slovenia, Slovakia, and Hungary require one-third of the directors on the supervisory board to represent employees.[28] There are even some traditional one-tier model countries that require some employee representatives, namely Luxembourg,[29] Sweden,[30] Denmark,[31] Finland,[32] and Norway.[33] The Netherlands abandoned its strongly pro-employee model in 2004 and now permits the works council to nominate one-third of directors (which then need to be elected by shareholders).[34] France previously required employee representation on the board in firms where employees held three percent of stock or more;[35] however, a new law passed in June 2013 will require employee representatives in firms with five thousand employees in France, or ten thousand employees worldwide.[36] Where labor representation on the board is not legally mandated, it occasionally happens voluntarily, for example, as a part of a bargain with a union (e.g., a bargain that may trade wage concessions for governance rights in a declining corporation (even in the United States)).[37]

PARTICIPATION.EU, http://www.worker-participation.eu/National-Industrial-Relations/Countries/Germany/Board-level-Representation (last visited Feb. 1, 2014).

26. MitbestG § 1(1).

27. See Arbeitsverfassungsgesetz [ArbVG] [Labor Constitution Act], Bundesgesetzblatt Teil I [BGBL I] No. 22/1974, § 110 (Austria).

28. *See* THOMAS RAISER, UNTERNEHMENSMITBESTIMMUNG VOR DEM HINTERGRUND EUROPARECHTLICHER ENTWICKLUNGEN, GUTACHTEN B FÜR DEN 66. DEUTSCHEN JURISTENTAG B 42 (2006). Slovenia initially adopted the German version of codetermination after gaining independence, but subsequently abandoned it after its constitutional court declared the system unconstitutional. *See id.*, at B 42–B 43; Rado Bohinc & Stephen M. Bainbridge, *Corporate Governance in Post-Privatized Slovenia*, 49 AM. J. COMP. L. 49, 58–60 (2001).

29. LOI DU 6 MAI 1974 [Law of May 6, 1974], MEMORIAL DU GRAND-DUCHE DE LUXEMBOURG [OFFICIAL JOURNAL OF LUXEMBOURG] A–No. 35, Art. 2, 620 (May 10, 1974).

30. 32 § LAG OM MEDBESTÄMMANDE I ARBETSLIVET [ACT ON CO-DETERMINATION IN THE WORKPLACE] (Svensk författningssamling [SFS] 1976:580) (Swed.).

31. RAISER, *supra* note 28, at B 43–B 44. Regarding the Danish system, see HERMAN KNUDSEN, EMPLOYEE PARTICIPATION IN EUROPE 81–95 (1995); Jesper Lau Hansen, *The Danish Green Paper on Company Law Reform—Modernising Company Law in the 21st Century*, 10 EUR. BUS. ORG. L. REV. 73, 89–90 (2009).

32. Laki yhteistoiminnasta yrityksissä [Act on Cooperation with Undertakings] (1978:725) (Fin.).

33. For an overview of the Nordic countries, see Caspar Rose, *The Challenges of Employee-Appointed Board Members for Corporate Governance: The Danish Evidence*, 9 EUR. BUS. ORG. L. REV. 215, 224–26 (2008).

34. *See* Bergerlijk Wetboek [BW] [Civil Code] bk. 2, tit. 4, art. 158(6) (Neth.). A rejection of the nominees of the works council is only possible for a limited number of reasons. *See* Groenewald, *supra* note 22, at 295 (describing the grounds for the shareholders to object to a nominee of the works council); *see also* Abe de Jong & Ailsa Röell, *Financing and Control in the Netherlands: A Historical Perspective*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 467, 473 (Randall K. Morck ed., 2005).

35. CODE DE COMMERCE [C. COM.] art. L225–23 (Fr.).

36. CODE DE COMMERCE [C. COM.] art. L225–27–1 (Fr.), introduced by Loi n° 2013-504 du 14 juin 2013 relative à la sécurisation de l'emploi [Law 2013-503 of June 14, 2013 Relating to Employment Production]. *See* S. de Vendeuil & O. Rault-Dubois, *Représentation des salariés au conseil d'administration ou de surveillance de grandes entreprises,* JCP E 2013, Etude 1379.

37. Simone M. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 309, 312, 315, 337–38 (2013) (discussing directors nominated by unionized workers).

Quite obviously, the purpose of putting employee representatives on the board of directors is not merely a symbolic one, but to ensure that employee interests are represented in board deliberation and decision making. When the United Kingdom considered employee representation on boards to be implemented in the 1970s, it did so under the rubric of "Industrial Democracy,"[38] the implication being that another group af-affected by the corporation's choices would need to be represented in the decision-making process.[39] One might therefore assume that employee representatives are intended to act as advocates.[40]

2. *Directors Appointed or Elected to Represent Specific Shareholders and Creditors*

The laws of some jurisdictions permit the corporate charter to stipu-stipulate that the holders of specific, registered shares have the right to appoint a certain number of directors.[41] Obviously, this is primarily an in-instrument for privately held firms, used to secure the balance of power between founders or their descendants. This kind of arrangement, how-however, also occasionally exists in publicly traded firms, in particular, those controlled by influential families. It is also common in joint ventures to stipulate for each parent company or partner to have the right to appoint a number of directors.[42]

Even if there are no specific provisions in the corporate charter, specific shareholders are often informally represented on the (superviso-(supervisory) board.[43] Publicly traded Continental European companies, more often than not, have a concentrated ownership structure characterized by the dominance of one controlling or several large

38. DEPARTMENT OF TRADE, REPORT OF THE COMMITTEE OF INQUIRY ON INDUSTRIAL DEMOCRACY, 1977, Cmnd. 6706, at 71, 95 (U.K.).

39. *Id.*

40. *E.g.*, MATHIAS HABERSACK, *in* 2 MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ § 100 para. 55 (Wulf Goette & Mathias Habersack eds., 3d ed. 2008) ("In the codetermined supervisory board . . . , a lack of independence is part of the program. In spite of the overarching goal of the 'interest of the enterprise', codetermination aims at a pluralism of interests, whose basis is not the least in the ability and task of the employee side to contribute employee issues to the deliberations of the board."); *see also* Klaus J. Hopt, *Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors' Conflicts of Interest*, *in* CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 285, 308 (Klaus J. Hopt & Gunther Teubner eds., 1985) (pointing out that while employee representatives have the same duty of loyalty as other directors under German law, "it would be naive to believe that the existing conflicts of interest could be solved or even negated in this way").

41. *E.g.*, Aktiengesetz [AktG] [Corporation Act] § 101(2) (Ger.) (permitting up to one-third of board members to be appointed by specific shareholders under the corporate charters). In the United Kingdom, the Companies Act does not stipulate how directors are appointed and does not even require an election. As Paul Davies explains, "there is nothing to prevent articles providing that directors can be appointed by a particular class of shareholders, rather than the shareholders as a whole, by debenture holders, or, indeed by third parties." PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW, para. 14–10 (8th ed. 2008); *see* Ahern, *supra* note 17, at 118.

42. Ahern, *supra* note 17 at 118–19.

43. *E.g.*, Sujit Sur et al., *Why Do Boards Differ? Because Owners Do: Assessing Ownership Impact on Board Composition,* 21 CORP. GOV. 373, 376 (2013) (noting the role of Bill Gates as chairman of Microsoft's board).

strategic shareholders.[44] A wealthy individual with large investments in several companies may not be willing or able to function as a director in all firms, but may deputize a trusted confidant, often a lawyer, to fulfill this function on her behalf.[45] If there are several large shareholders, the dominating groups will typically come to terms with each other and create an arrangement where each of them has some governance role.[46] While an industrial family might send a member,[47] a corporate shareholder will typically nominate an officer or other senior employee.[48] For this situation to persist, the various large shareholders will obviously vote for each others' candidates.[49] Sometimes shareholders enter into a voting agreement that formalizes rights to nominate a specified number of directors for each participant.[50] Nominated directors are also often members of the board of subsidiaries within a group of companies.[51] In the United States, the scenario of "constituency directors" representing specific shareholders is becoming more common because of the presence of private equity and venture capitalists.[52]

Important creditors may be part of such a coalition as well, in particular, those cases where the corporation has a close relationship with a specific bank (*Hausbank* in German), that may or may not also be a significant shareholder.[53] While U.S. banks do not play the role in corporate governance that German banks do, the situation may

44. *E.g.,* PETER A. GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL 18 (2005) (creating an index for concentration of stock ownership in different countries); Marco Becht & Alisa Roëll, *Blockholdings in Europe: An International Comparison,* 43 EUR. ECON. REV. 1049 (1999); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 J. FIN. ECON. 365 (2002) 379–80; Raphael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World,* 54 J. FIN. 471 (1999).

45. *See, e.g.*, Bruno Kropff, *Aufsichtsratsmitglied "im Auftrag," in* FESTSCHRIFT FÜR ULRICH HUBER ZUM SIEBZIGSTEN GEBURTSTAG 841, 842 (Theodor Baums et al. eds., 2006) (giving the example of the former role of the late Leo Kirch in the German Springer media group).

46. *E.g.*, *id.* (giving the example of different branches of a founding family).

47. Deborah A. DeMott, *Guests at the Table?: Independent Directors in Family-Influenced Public Companies*, 33 J. CORP. L. 819, 823 n.15 (2008) (giving the example of Estée Lauder Companies).

48. *E.g.*, Roberto Barontini & Lorenzo Caprio, *The Effect of Family Control on Firm Value and Performance: Evidence from Continental Europe*, 12 EUR. FIN. MGMT. 689, 691 (2006) (analyzing, among other things, the role of family members as CEOs and nonexecutive directors of publicly traded firms founded by an ancestor); Sur et al., *supra* note 44, at 376–77 (discussing how corporate owners may use directors to safeguard supply chains or the inflow of resources through affiliated directors).

49. Mathias Habersack, in a standard treatise of the German corporate law, points out that the supervisory board developed as a representation of shareholders, which implied that a controlling (corporate shareholder) would traditionally have elected only her representatives. HABERSACK, *supra* note 40, § 100 para. 54.

50. *See, e.g.*, DeMott, *supra* note 48, at 823; D. Gordon Smith, *Duties of Nominee Directors*, *in* COMPARATIVE COMPANY LAW 61, 62, 64, 67, 69 (Mathias Siems & David Cabrelli eds., 2013) (noting that the practice of such shareholder agreements is legal or common in the United States, the United Kingdom, France, and Germany).

51. *E.g.*, *Kuwait Asia Bank EC v. National Mutual Life Nominees Ltd.* [1991] 1 AC 187 (P.C.) (N.Z.).

52. Veasey & Di Guglielmo, *supra* note 15, at 763.

53. *See, e.g.*, Gary Gorton & Frank A. Schmid, *Universal Banking and the Performance of German Firms*, 58 J. FIN. ECON. 29, 66 (2000) (discussing the representation of banks on German supervisory boards); Andreas Hackethal et al., *Banks and German Corporate Governance: On the Way to a Capital Market-Based System?*, 13 CORP. GOV. 397, 398 (2005); Hopt, *supra* note 40, at 305–06 (discussing bank representation on boards).

sometimes be not all that different: A study based on 1992 data found that 136 out of 430 large firms (in the Forbes 500) had one or more bankers on the board.[54] Similarly, in 2000, approximately twenty-five percent of the largest firms had bankers on the board.[55]

Today, the lines between debt and equity are often fluid; whether a venture capitalist takes a debt or equity position is a matter of financial optimization and the circumstances of the case.[56] Lending contracts sometimes permit creditors to put a director on the debtor's board when it experiences financial distress.[57] In all of these cases, it is obvious that the respective board member was elected to represent the interest of the nominating entity. In fact, directors of this type are often subject to conflicting interests and duties as members of the bodies of different corporations, whose interests may not always be aligned.[58]

3. Government Representatives

State actors often interact with the economy on various levels. In particular, governments have sometimes used appointment rights or their informal influence to secure the election or appointment of directors to the board to represent their interests. Directors of this type often have a political function or may be employees of a political body.[59] In such cases, the purpose is often to retain a certain degree of control in privatized firms that were, in part, thought to be of particular national importance. In the European context, this is illustrated in particular by the "Golden Share" case law (as well as in the "Volkswagen" case) of the European Court of Justice ("ECJ"):[60] Since the early 2000s, the ECJ has routinely struck down special laws and charter provisions that gave special rights to a national government as a shareholder. The basis of these decisions was the finding that these instruments were in violation of the principle of freedom of movement of capital enshrined in the EU Treaty.[61] While

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54. Randall S. Kroszner & Philip E. Strahan, *Bankers on Boards: Monitoring, Conflicts of Interest, and Lender Liability*, 62 J. FIN. ECON. 415, 423 (2001).

55. João A.C. Santos & Adrienne S. Rumble, *The American Keiretsu and Universal Banks: Investing, Voting and Sitting on Nonfinancials' Corporate Boards*, 80 J. FIN. ECON. 419, 437 (2006).

56. Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1217 (2006).

57. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 779 (2002).

58. *See, e.g.*, KLAUS J. HOPT & MARKUS ROTH, 4 GROSSKOMMENTAR AKTIENGESETZ, § 116 para. 174 (Klaus J. Hopt & Herbert Wiedemann eds., 2005) (recommending that directors either abstain from voting, recuse themselves, or resign their position in such cases).

59. Daniela Weber-Rey & Jochen Buckel, *Corporate Governance in Aufsichtsräten von öffentlichen Unternehmen und die Rolle von Public Corporate Governance Kodizes,* 177 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 13, 14 (2013).

60. Case C-112/05, Comm'n v. Germany (*Volkswagen*), 2007 E.C.R. I-9020; Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4785 (Golden Share allowing, among other things, the government to appoint two directors, struck down by the ECJ).

61. *See, e.g.*, Wolf-Georg Ringe, *Company Law and Free Movement of Capital*, 69 CAMBRIDGE L.J. 378 (2010); Nicola Ruccia, *The New and Shy Approach of the Court of Justice Concerning Golden Shares*, 2013 EUR. BUS. L. REV. 275. In some cases, the government had the right to appoint directors. *E.g.*, Case C-112/05, Comm'n v. Germany (*Volkswagen*), 2007 E.C.R. I-9020; Case C-503/99, Comm'n

government representatives may, thus, constitute a slowly dying species in Europe, state ownership in large firms made a temporary comeback in the United States with the Troubled Asset Relief Program ("TARP").[62] In some cases, financial institutions that had missed repayment deadlines had to allow the Treasury Department to appoint members to their boards.[63]

Government ownership, whether through representatives on the board or not, raises the concern that the board will pursue interests designated as "public."[64] In fact, as government employees, such representatives may be subject to directions given by their superiors, which will likely conflict with their duties under corporate law.[65] While the state will not typically seek to enrich itself, political goals such as full employment or providing particular goods and services to consumers are often at odds with the profit-making goal typically pursued by other shareholders of the firm.[66] Again, the ECJ case law serves as a good illustration of this perception: the court's rationalization why special rights for government actors impede the free movement of capital is not discrimination of foreign investors, but that these measures are, in the court's view, likely to deter investors from other member states.[67] While this is obviously true in cases where a government entity can veto the acquisition of shares,[68] in other cases one might challenge this assumption: Shareholders can also benefit from a close relationship with the government, both because of better business opportunities, and because the government is unlikely to let such a company go under.[69] After all, in practice, such firms still attract investment in the stock market, although they might be trading at a discount compared to similar firms.[70] Nevertheless, the clear underlying

v. Belgium, 2002 E.C.R. I-4812 (only case where the Golden Share passes muster even though government had the right to appoint two directors); Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4785 (Golden Share allowing, among other things, the government to appoint two directors, struck down by the ECJ).

62. *E.g.*, Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 ENTREPRENEURIAL BUS. L.J. 561, 569–73 (2010) (reviewing bailout legislation).

63. William O. Fisher, *When the Government Attempts to Change the Board, Investors Should Know*, 40 PEPP. L. REV. 533, 536–52 (2013) (describing how the federal government put directors on the boards of AIG and Bank of America); Sepe, *supra* note 37, at 312, 339–40.

64. *See* Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1317–19 (2011) (describing conflicts of interest between the government and other shareholders resulting from political objectives). *But see* Amir N. Licht, *State Intervention in Corporate Governance: National Interest and Board Composition*, 13 THEORETICAL INQ. L. 597, 600–01 (2012) (noting that Israeli law in theory requires government-appointed directors to act in the "best interest of the corporation").

65. *E.g.*, Kropff, *supra* note 46, at 849–54 (discussing different views under German law and concluding that instructions are not binding where they are contrary to the interest of the corporation).

66. Licht, *supra* note 65, at 601.

67. Case C-112/05, Comm'n v. Germany (*Volkswagen*), 2007 E.C.R. I-9020, I-9040 ¶ 66; Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4785, I-4802 ¶ 41.

68. Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4785, I-4796.

69. *See* Mariana Pargendler et al., *In Strange Company: The Puzzle of Private Investment in State-Controlled Firms*, 46 CORNELL INT'L L.J. 569, 573–78 (2013) (discussing economic aspects and agency cost in "mixed firms").

70. *Id.* at 591 (discussing *ex ante* discounting by investors).

assumption is that government interests will detract from profit-making goals, making firms less efficient per this definition.

4. *Minority Representatives*

Several jurisdictions have mechanisms that—at least in theory—enable minority shareholders to elect one or more directors to the (supervisory) board against the will of the majority under certain conditions. Cumulative voting, which is no longer common but still permissible in the United States,[71] is a prominent example; mechanisms such as the failed SEC Proxy Access Rule go in the same direction.[72] Since 2006, Italian law permits that minority shareholders exceeding certain thresholds present lists for the election of candidates to the board of directors, and stipulates that in a contested election, at least one director from the list receiving the second largest number of votes is appointed to the board.[73] Spanish corporate law allows groups of shareholders to designate a proportion of directors corresponding to the number of shares held.[74] This could raise the question whether the elected minority representative should have a specific duty to look out for the interest of the minority shareholders who elected her or for minority shareholders in general where their interests are at odds with those of the majority.

Another type of director more familiar to American readers is very close to this category, namely independent directors, although they do not quite fit the bill. With the development of agency theory and the growth of the corporate governance movement, independent directors began to populate corporate boards.[75] In the United States, this began with the corporate governance movement in the late 1970s and 1980s.[76] At the same time, "disinterested" directors began to play an even greater role in the corporate case law, where they helped to insulate board deci-

71. *E.g.*, DEL. CODE ANN. tit. 8, § 214 (West 2013).

72. The SEC famously introduced Rule 14a-11 in 2010, which would have facilitated the nomination of candidates for directorships by minority shareholders. The rule was subsequently struck down by the Court of Appeals for the District of Columbia. Bus. Roundtable v. SEC, 647 F.3d 1144, 1156 (D.C. Cir. 2011).

73. *See* D.Lgs. 2012 17 dicembre 2012, n. 221; *see, e.g.*, Corrado Malberti & Emiliano Sironi, *The Mandatory Representation of Minority Shareholders on the Board of Directors of Italian Listed Corporations: An Empirical Analysis* 13–14 (Bocconi Univ. Inst. of Comparative Law, Legal Studies Research Paper No. 18, 2007), *available at* http://ssrn.com/abstract=965398; Marco Ventoruzzo, *Les administrateurs nommés par la minorité en droit italien des sociétés cotées*, 2007 REVUE DES SOCIETES 509 (2007).

74. Ley de Sociedades Anonimas art. 137 (B.O.E. 1989, 310) (Spain). For example, if there are five directors, a minority of twenty percent can designate a director.

75. *See, e.g.*, Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1472–76 (2007).

76. One of the most notable achievements of this movement were American Law Institute's ("ALI") Principles of Corporate Governance, which emphasize the role of outside directors. *See* AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994); Barry D. Baysinger & Henry N. Butler, *Race for the Bottom v. Climb to the Top: The ALI Project and Uniformity in Corporate Law*, 10 J. CORP. L. 431, 444–46 (1985) (describing the ALI Principles project); James D. Cox, *The ALI, Institutionalization, and Disclosure: The Quest for the Outside Director's Spine*, 61 GEO. WASH. L. REV. 1233, 1233 (1993) ("[T]he outside director is the linchpin of the ALI's regulatory and procedural provisions.").

sions against charges of self-interested behavior of corporate insiders, and, thus, the Delaware courts began to be more deferential to committees composed of independent directors.[77] This culminated in the requirement of the Sarbanes-Oxley Act of 2002 that issuers must have audit committees composed entirely of independent directors.[78] What distinguishes these functions from minority representatives is that they are not intended to advance the interests of a particular group; rather, they are intended to monitor executive management decisions to the benefit of the corporation as a whole.[79]

B. Constituency Directors and the Structure of the Financial System

The proceeding Section could give the impression that "constituency directors" of all stripes are primarily a foreign habit, alien to the American corporate governance system. But as corporate practice, case law, and the increasing debate show, these "intruders in the boardroom"[80] are a growing phenomenon. But why have constituency directors been common abroad—sometimes even enshrined in mandatory law—while they seem to be new in the United States?

A helpful way of interpreting the phenomenon is provided by looking at the larger framework of corporate governance. The increasing heterogeneity on the board can be seen as the consequence of a larger trend, especially in the United States. Traditionally, U.S. corporate governance has been dominated by managerial capitalism. Since the time of Berle and Means,[81] the dominant narrative was one of a separation of ownership and control: a multitude of small shareholders, many of them retail investors and unable to coordinate, were facing an all-powerful board and strong management.[82]

The "varieties of capitalism" literature in economic sociology, which in recent years has been increasingly applied to the law as well,[83] has, in the past, identified different capitalist systems, and, within these, differ-

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77. Takeover law is an important case in point. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1147–48 (Del. 1989) (discussing the meeting frequency of independent directors); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 950 (Del. 1985) (noting the private deliberations and consultations of independent directors in upholding the boards' takeover defenses); Gordon, *supra* note 76, at 1523–26 (discussing the judicial promotion of director independence in the Delaware takeover case law).

78. Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1 (2012).

79. *E.g.*, Wolf-Georg Ringe, *Independent Directors: After the Crisis*, 14 EUR. BUS. ORG. L. REV. 401, 408–09 (2013) (discussing the function of independent directors).

80. Sepe, *supra* note 37.

81. ADOLF A. BERLE JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–6, 333 (1933).

82. *See, e.g.*, GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RESHAPED AMERICA 72–77 (2009) (discussing managerial dominance during this period); DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 108–11 (2005) (same); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 444 (2001) (same).

83. *See generally* CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW & CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 36–38, 182–92 (2008).

ent corporate governance systems. In this body of work, one major categorization was the distinction between market-based and coordinated capitalist systems: While the former describes a system based on individual market transactions, the latter is based on large-scale coordination through aggregated interest groups such as unions and employer associations relying on collective bargaining.[84] A related distinction is the one between "arm's length" or "outsider" systems on the one hand, and "control-oriented" or "insider" financial systems on the other hand; in an outsider system, investors provide funds through a market, whereas in an insider system, firms obtain finance from concentrated relational investors, such as banks or strategic large shareholders (e.g., families), as opposed to stock and bond issuances that dominate the financing of U.S. firms.[85]

The patterns we saw in Section A—namely the higher prevalence of constituency directors in some systems rather than in others—thus fits the larger pattern of the corporate governance system: In market-based corporate governance systems, financial investors interact with the firm through the market, as firms typically resort to equity issuing to meet financing needs.[86] If investors are dissatisfied, they sell their stock, and management hopefully will get the message. In such a system, there is little space or need for representative directors. Directors' function is to serve the interests of the firm as a whole.

By contrast, insider systems, such as the German one, more often relied on "constituency directors," either informally appointed by a large shareholder or bank or formally elected by labor.[87] Similarly, banks and insurance firms—both in their capacity as lenders and as frequent large shareholders—relied on their representatives on the supervisory board to make their voice heard and to obtain information about the firms in which they owned a significant stake.[88]

Similarly, in systems with strong government influence, such as the French one, the government used this technique as well. In the French "mixed economy," (i.e., in firms with a significant government stake) typically the government would informally get to nominate a number of directors.[89] In Germany, where government influence in the economy has traditionally been less pervasive, this technique was even used in a very stringent legislative form in the Volkswagen Act: This federal law, which

84. RICHARD W. CARNEY, CONTESTED CAPITALISM: THE POLITICAL ORIGINS OF FINANCIAL INSTITUTIONS 3 (2010); Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, *in* VARIETIES OF CAPITALISM 1, 8–9 (Peter A. Hall & David Soskice eds., 2001).

85. *E.g.*, ALAN DIGNAM & MICHAEL GALANIS, THE GLOBALIZATION OF CORPORATE GOVERNANCE 43–44 (2009); Erik Berglöf, *A Note on the Typology of Financial Systems*, *in* COMPARATIVE CORPORATE GOVERNANCE 151, 159–64 (Klaus J. Hopt & Eddy Wymeersch eds., 1997).

86. CARNEY, *supra* note 85, at 5.

87. *See* Sepe, *supra* note 37, at 337.

88. *See supra* notes 41–59 and accompanying text.

89. *E.g.*, Bernardo Bortolotti & Mara Faccio, *Government Control of Privatized Firms*, 22 REV. FIN. STUD. 2907, 2918 (2009) (discussing the presence of directors "to act on behalf of the minister" in Elf-Aquitaine and other French firms).

was found to be in conflict with the European freedom of movement of capital, entitled each of the Federal Republic and the State of Lower Saxony to appoint a number of directors as long as the respective entity held a single share.[90]

Two fundamental changes have been afoot in the United States in recent decades. First, the significance society attributes to shareholders has increased.[91] This development has been strongly influenced by shifts in how Americans save for their retirement. While up to the 1970s, middle-class Americans often received defined-benefit pensions from their employers, today the typical way of saving for one's retirement is the ubiquitous 401(k) plan, which is based on the defined contribution principle.[92] Consequently, investment risk has been shifted from employers to employees,[93] and the United States has become a nation of shareholders, even if this ownership is mitigated through investment vehicles such as mutual funds.[94] In this new "shareholder capitalism," firms still interact with providers of financial capital through the stock market, but the political balance has shifted somewhat toward shareholders: If everyone is a shareholder, the shareholder interest is a politically palatable position in particular for the center-left.[95] In this updated model, the board still serves the company as a whole, but with an increased emphasis on the interests of outside investors. The corporate governance movement and independent directors fit well into this world.

The second shift is a consequence of the first shift (which was already recognized by Robert Clark in 1981):[96] An increasing share of corporate America is held by institutional investors, whose share has increased at the expense of retail investors.[97] Pension funds, mutual funds,

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90. *See supra* notes 61–62 and accompanying text.

91. *E.g.*, Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 915–21 (2013); Hansmann & Kraakman, *supra* note 83, at 444; Gregory Jackson, *The Origins of Nonliberal Corporate Governance in Germany and Japan*, *in* THE ORIGINS OF NONLIBERAL CAPITALISM: GERMANY AND JAPAN IN COMPARISON 121, 127 (Wolfgang Streeck & Kozo Yamamura eds., 2001) ("Only in the 1980s was the separation of ownership and control . . . eclipsed by 'investor capitalism.'").

92. *See* EDWARD A. ZELINSKY, THE ORIGINS OF THE OWNERSHIP SOCIETY: HOW THE DEFINED CONTRIBUTION PARADIGM CHANGED AMERICA 33–37 (2007).

93. *Id.* at 6–11.

94. DIGNAM & GALANIS, *supra* note 86, at 66–67 (explaining the significance of pension savings for the financial system); *see generally* PETER ALEXIS GOUREVITCH & JAMES J. SHINN, POLITICAL POWER & CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE 219–20 (2005) (discussing the political effects of defined contribution pension plans); Gelter, *supra* note 92, at 948–63 (same).

95. JOHN W. CIOFFI, PUBLIC LAW AND PRIVATE POWER: CORPORATE GOVERNANCE REFORM IN THE AGE OF FINANCE CAPITALISM 97–139 (2010); GOUREVITCH & SHINN, *supra* note 95, at 210–11; Gelter, *supra* note 92, at 949–52.

96. Robert Charles Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561, 565–66 (1981).

97. *E.g.*, THE CONFERENCE BD., THE 2010 INSTITUTIONAL INVESTOR REPORT: TRENDS IN ASSET ALLOCATION AND COMPOSITION 22 tbl.10 (2010) (showing that more than fifty percent of shares are now owned by institutional investors); Paul H. Edelman et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359 (2014); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 995–1001 (2010).

and hedge funds have all increased their stakes.[98] Managerial entrenchment is eroding, and shareholder power is on the rise.[99]

In recent years, this has resulted in a more heterogeneous shareholder structure that has begun to replace the homogenous mass of investors of the Berle-Means corporation; consequently, there is an increasing population of shareholders, including private equity investors, who want their voices to be heard more explicitly in the boardroom. Gilson and Gordon have even identified a "reconcentration of ownership" of shares.[100] In a certain way, the United States is beginning to resemble other jurisdictions where this has always been the case, albeit with some important twists. Even though the nature of the typical institutional investor is very different (e.g., from a bank in traditional German corporate governance), the principle is the same: a significant shareholder who is strongly exposed to the firm's idiosyncratic risk will seek ways to manage that risk by influencing the firm.

It would be too much to say that the U.S. economy overall is moving from a market-based system toward a coordinated system. When we look not only at the financial system, but also the role of labor, the United States clearly looked more "coordinated" than "market-oriented" from the 1950s through the 1970s when unions were powerful actors; in the labor dimension, the trend has likely been one from a coordinated or "insider" system toward a market-based outsider system, in which labor has become a more fungible commodity.[101] We can clearly identify a trend, however, in the financial dimension of corporate governance: The current reconcentration of share ownership in institutional hands indicates that the United States "variety of capitalism" is undergoing realignment. A greater frequency of powerful shareholders thus matches a more frequent presence of "constituency directors" that have a special relationship with their appointer or nominator.

98. Edelman et al., *supra* note 98, at 1382.

99. *See generally* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907 (2013) (arguing the United States has shifted from a manager-centric system to a shareholder-centric system). Arguably, "closet" managerialism is returning in the form of firms with multiple voting shares that entrench their founder-managers very effectively. Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1181–84 (2013). At present, however, this trend seems to be restricted to relatively new firms in the IT and private equity industries. *Id.* at 1182–83.

100. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 886 (2013).

101. *See* Gelter, *supra* note 92, at 937–41 (describing how defined-benefit plans helped to tie employees to employers and this system declined with the rise of defined contribution plans); Michael L. Wachter, *Labor Unions: A Corporatist Institution in a Competitive World*, 155 U. PA. L. REV. 581, 583 (2007) (summarizing a development from a "corporatist-regulated economy to one based on free competition").

III. THE LAW ON THE BOOKS: CORPORATE PURPOSE AND UNIFORM FIDUCIARY DUTIES

If constituency directors are becoming more common, how does the law deal with them? Should they *individually* be expected to represent the interests of the group or individual they represent, or should they follow a *joint* objective? Interestingly, across jurisdictions, the answer given by corporate law is the latter. But what is this objective? On this, jurisdictions typically do not give a clear answer—not even the United States. The debates oscillate between pure shareholder wealth maximization and the pursuit of the welfare of all conceivable stakeholders of the firm. With that elusive objective in mind, however, jurisdictions impose a single set of fiduciary duties on directors—namely benefiting the corporation "as a whole," even if it is not clear what this precisely means.[102] The question for constituency directors with different personal loyalties is then how this objective is defined and how deliberation of a heterogeneous group of individuals may serve the objective of developing the definition in the specific firm's context. Section A explores debates about corporate purpose, while Section B asks how uniform fiduciary duties relate to it.

A. The Elusive Corporate Purpose

The debate about the proper objective of corporate fiduciaries is old and can hardly be considered conclusive. In the United States, the courts, in particular those in Delaware, routinely and laconically state that directors are required to act for the benefit of "the corporation"; more often than not "and its shareholders" is appended to this progression of words.[103] Still, it is controversial whether directors are beholden to a "shareholder primacy" norm, or whether they should be required or permitted to consider interests of other groups in the firm, such as creditors, employees, suppliers, customers, and local communities—summarily described as "other constituencies" or "stakeholders." The famous statement of the Supreme Court of Michigan in the 1919 decision of *Dodge v. Ford*,[104] according to which fiduciaries are required to work on behalf of shareholders—and no one else—has not been met with unanimous assent, both as a matter of policy and as a matter of law. Gordon Smith persuasively showed that the ruling arose from an intra-shareholder conflict against the backdrop of an underdeveloped law of minority oppression.[105] Lynn Stout has more recently called upon law professors to stop teaching the case, which in her view is primarily the

102. Veasey & Di Guglielmo, *supra* note 15, at 768.
103. *Id.* at 764 n.8; Sepe, *supra* note 37, at 340 n.128; *see, e.g.*, N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99, 101 (Del. 2007); Guth v. Loft, Inc., 5 A.2d 503, 509 (Del. 1939). A recent case probably contains the clearest verbalization of shareholder primacy in the Delaware courts so far. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 26 (Del. Ch. 2010).
104. 170 N.W. 668 (Mich. 1919).
105. Smith, *supra* note 18, at 315–20.

object of academic debate and of hardly, if any, relevance in practice.[106] David Yosifon has attempted to rebut the latter claim in particular and argued that, doctrinally speaking, the shareholder primacy norm remains good law.[107] Nevertheless, the majority view seems to be that it is largely unenforceable because of the business judgment rule.[108] Even Henry Ford would likely have been able to win his case if he had not obstinately—and against the better judgment of counsel—testified his belief that the objective of the Ford Motor Corporation was to "do as much good as we can, everywhere, for everybody concerned. And incidentally to make money."[109] Policy debates have essentially gone in circles since the famous Berle-Dodd exchange in the early 1930s: while Adolf Berle wanted to constrain managers to be fiduciaries of shareholders,[110] Merrick Dodd saw the board of directors well-positioned to pursue the public interest.[111]

Continental European corporate laws have had their own versions of this debate which is related, but postdates debates about corporate personhood.[112] With the shift from conceptualism (in German: *Begriffsjurisprudenz*) toward functionalism (*Interessenjurisprudenz,* later *Wertungsjurisprudenz*) in the late 19th and early 20th Century, we can identify a tension between a contractual and an institutional view of the

106. Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008).

107. David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181 (2014).

108. *E.g.*, Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1321–23 (2008).

109. *E.g.*, M. Todd Henderson, *The Story of* Dodge v. Ford Motor Company*: Everything Old is New Again*, *in* CORPORATE LAW STORIES 37, 62 (J. Mark Ramseyer ed., 2009); *see also* Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law,* 59 ALA. L. REV. 1385, 1418–19 (2008) (noting that shareholder primacy was only discussed because Henry Ford said that profits for shareholders were only an incidental benefit, and that the court effectively deferred to his business judgment by permitting his expansion plan to go forward).

110. A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); A. A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

111. E. Merrick Dodd, Jr., *For Whom Are Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). Bratton and Wachter have recently critiqued the predominant view of Berle as a precursor of shareholder wealth maximization and Dodd as an early stakeholderist. These authors have persuasively argued that Berle, as a New Deal progressive, primarily hoped to constrain corporations, while Dodd allied himself with business interests that thought that managerial planning could bring the economy back on track. William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and* The Modern Corporation, 34 J. CORP. L. 99 (2008).

112. In German law, the name of Otto von Gierke is typically associated with the "entity" theory of the corporation. Gierke understood legal personality as the reflection of social reality and argued that individuals would form fellowships that developed an autonomous existence necessary for their social fulfillment. OTTO GIERKE, DAS DEUTSCHE GENOSSENSCHAFTSRECHT (1868). Regarding Gierke, see, e.g., ROGER SCRUTON, THE PHILOSOPHER ON DOVER BEACH 59 (1990); Ron Harris, *The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business*, 63 WASH. & LEE L. REV. 1421, 1431–35 (2006) (describing the reception of Gierke's theories in Britain and the United States); Hasso Hofmann, *From Jhering to Radbruch: On the Logic of Traditional Legal Concepts to the Social Theories of Law to the Renewal of Legal Idealism*, *in* 9 A HISTORY OF THE PHILOSOPHY OF LAW IN THE CIVIL LAW WORLD 1600–1900, 301, 335 (Damiano Canale et al. eds., 2009); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 178 (1985). During this period, however, a shareholder-stakeholder debate was not yet on the horizon.

corporation.[113] The contractual view emphasizes the origin of the role of the business association as an agreement between shareholders, and thus naturally lends itself to a shareholder primacy interpretation.[114] The contrary "institutional" view of the functionalist period can be traced to the German business leader, intellectual, and politician Walther Rathenau.[115] Writing in 1917, he was deeply troubled by the idea that corporations should pursue shareholders' financial interests, given that they had obtained a profound importance for society and the economy as a whole. Rathenau, who was assassinated in 1922, did not live to see his work trigger an intense debate about the nature of the corporation around 1930.[116] His views, as described the "*Unternehmen an sich*" (business enterprise as such) by Haussmann in 1930, seemed to imply that large business corporations had long emancipated themselves from the interests of shareholders and rather developed a freestanding function as sociological entities in their own right.[117] Haussmann, by contrast, argued that firms should pursue the collective interest of shareholders.[118]

This institutional view was famously recognized by German legislation in 1937, at a time, however, when it was infused with blood-and-soil language that the liberal Rathenau had never imagined.[119] The language was cleansed from the *Aktiengesetz* in 1965, while it was generally agreed that corporations were required to look at more than the mere interest of shareholders.[120]

Nevertheless, in the 1960s and 1970s, the view that corporations, as legal entities, reflected a broader social reality swept Continental Europe. In France, the *doctrine de l'entreprise* began to develop.[121] It fo-

113. *See generally* Remus Titiriga, *The "Jurisprudence of Interests" (Interessenjurisprudenz) from Germany: History, Accomplishments, Evaluation*, 3 INT'L J.L., LANGUAGE & DISCOURSE 55 (2013) (describing the history and shift from Interessenjurisprudenz to Begriffsjurisprudenz).

114. Note that this contractarian view should not be confused with the "nexus of contracts" view of economic analysis. The traditional *legal* contractarian view equates the corporation with a single contract between shareholders. "Nexus of contracts" refers to a network of contracts that includes all individuals that interact with each other through the corporation. It also does not necessarily imply shareholder primacy, which makes the additional assumption that all nonshareholder groups are protected by complete contingent contracts.

115. Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J.L. & BUS. 641, 680 (2011).

116. *Id.* at 680–81 & n.168.

117. WALTHER RATHENAU, VOM AKTIENWESEN: EINE GESCHÄFTLICHE BETRACHTUNG (1918) (Ger.).

118. Fritz Haussmann, *Gesellschaftsinteresse und Interessenpolitik in der Aktiengesellschaft*, 30 BANK-ARCHIV 57, 64–65 (1930) (Ger.). On the debate, see, e.g., Gelter, *supra* note 116, at 683–88.

119. *See* AKTIENGESETZ [AKTG] [Stock Corporation Act], Jan. 8. 2009, BGBL. I, § 70 (Ger.) (requiring the management board "to manage the corporation as the good of the enterprise and its retinue and the common wealth of folk and realm demand").

120. Gelter, *supra* note 116, at 696; Friedrich Kübler, *Dual Loyalty of Labor Representatives*, *in* CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 429, 439 (Klaus J. Hopt & Gunther Teubner eds., 1985) (suggesting that the consideration of nonshareholder interest was seen as the consequence of social responsibility attaching to private property under the West German constitution).

121. CLAUDE CHAMPAUD, LE POUVOIR DE CONCENTRATION DE LA SOCIETE PAR ACTIONS (1962) (Fr.); RAFAËL CONTIN, LE CONTROLE DE LA GESTION DES SOCIETES ANONYMES (1975) (Fr.); JEAN PAILLUSSEAU, LA SOCIETE ANONYME, TECHNIQUE: D'ORGANISATION DE 'ENTREPRISE (1967) (Fr.); *see also* Gelter, *supra* note 116, at 705–09 (discussing the development of these theories). For

cused on the role of the business enterprise interpreted, and in part because of its influence, the legal concept of *intérêt social* or *intérêt de la société* (interest of the association) is often seen as transcending the mere interests of shareholders and identified with the *intérêt de l'entreprise* (interest of the business enterprise).[122] Similarly, in Italy, scholars began to debate the *interesse sociale* as possibly being distinct from the mere interests of shareholders.[123] During this period, even the United Kingdom began to open its corporate law to a broader vision, as a statute enacted in 1980 required directors to have regard to "the interests of the company's employees in general, as well as the interests of its members."[124]

The German discussion was refueled by the enactment of the Codetermination Act of 1976, which increased the proportion of employee representatives on the supervisory boards of the largest firms to one-half.[125] At this point, it seemed to have become clear that a corporation, members of whose supreme monitoring (and in some respects, deciding) body were not exclusively elected by shareholders, could hardly have the objective of producing only financial profits.[126] Some commentators went so far as to say that the *Aktiengesellschaft* (corporation, literally meaning "share association") was in the process of transforming into an *Aktienunternehmen (*"share undertaking"), in other words a business incidentally financed through stock issues.[127] While the distinction rarely attained practical relevance in court,[128] treatises of this period typically

more recent assessments, see CLAUDE CHAMPAUD, MANIFESTE POUR LA DOCTRINE DE L'ENTREPRISE (2011) (Fr.); Didier Danet, *Pour en finir avec le financialisme : la doctrine de l'entreprise*, *in* L'ENTREPRISE DANS LA SOCIETE DU 21E SIECLE 35 (Claude Champaud ed., 2013).

122. *See, e.g.*, PHILIPPE MERLE & ANNE FAUCHON, DROIT COMMERCIAL. SOCIETES COMMERCIALES para. 52-1 (13th ed. 2009) (Fr.); Christiane Alcouffe, *Judges and CEOs: French Aspects of Corporate Governance*, 9 EUR. J.L. & ECON. 127, 133 (2000).

123. *See* PIER GIUSTO JAEGER, L'INTERESSE SOCIALE (1964) (It.). Similar institutional theories were at least discussed in other civil law jurisdiction. *See, e.g.*, Kristoffel Grechenig, *Discriminating Shareholders Through the Exclusion of Pre-emption Rights?*, 4 EUR. COMPANY & FIN. L. REV. 571, 580 (2007) (reporting the existence a debate between a contractual and an institutional theory in Spain); Kyung Hoon Chun, *Whose Interests Should the Managers Serve? – Insights from Recent Korean Cases on LBO Transactions* 4–6, 13–14 (Seoul Nat'l Univ., 2011), *available at* http://ssrn.com/abstract =1828652 (discussing the role of the "corporation itself" doctrine in South Korea).

124. Companies Act of 1980, c. 22, § 46(1) (U.K.) (subsequently Companies Act of 1985, c. 6, § 309(1) (U.K.)). The final version of the statute, enacted under Margaret Thatcher in 1980, did not include a way of enforcing it for employees. On the debate, specifically a previous draft that might have permitted enforcement, see Allen Lowrie Mackenzie, *The Employee and the Company Director*, 132 NEW L.J. 688, 689–90 (1982).

125. Mitbestimmungsgesetz [MitbestG] [Co-determination Act], May 4, 1976, BGBL. I at 1153, § 7 (Ger.).

126. This is the argument typically found in the doctrinal literature. *E.g.*, KLAUS J. HOPT, *in* 3 GROSSKOMMENTAR AKTIENGESETZ, § 93 para. 151 (Klaus J. Hopt & Herbert Wiedemann eds., 1998).

127. *E.g.*, Wolfgang Schilling, *Das Aktienunternehmen*, 144 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 136 (1980).

128. The notable Mannesmann decision of 2005 is maybe the most prominent exception. (Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 21, 2005, ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFFES IN STRAFSACHEN [BGHST] 50, 331 (Ger.). Regarding the case, see, e.g., CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM 69–74 (2008); Peter Kolla, *The Mannesmann Trial and the Role of the Courts,* 5 GERMAN L.J. 829 (2004).

explained that the overall goal was the long-term sustainability and profitability of the corporation for the benefit of all its constituencies.[129]

In the 1990s, both France and Germany began to experience some degree of backlash and a growing line of argument suggesting that "shareholder value maximization" might be in the supreme interest of the business enterprise.[130] The French legal debate, for example, saw an increased criticism of the prevailing understanding of the *intérêt social*. Dominique Schmidt, a leading contemporary proponent of a contractual view of the corporation in France, seeks to identify it with the *intérêt commun* (common interest) of shareholders.[131] In the United Kingdom, where the statute mentioned above had never achieved practical significance,[132] the Companies Act of 2006 clarified that any obligation directors might have to have regard for constituencies other than shareholders are only instrumental for the benefit of the company's members.[133]

B. Uniform Fiduciary Duties

How does the often heterogeneous composition of the board relate to the uniform purpose corporations are supposed to have? The heterogeneous nomination process may create a situation where a nominated (or, more generally, constituency) director will show regard for the interests of the nominator after appointment.[134] In connection with such director's special situation, the way the duty of loyalty is discharged is of specific interest.

In spite of the heterogeneity of directors between and within countries just outlined, all major jurisdictions, of which we are aware, developed a strongly uniform duty of loyalty for all directors. In all countries, the historical basis tended to be grounded in case law as opposed to stat-

129. On the various theories how to define the "interest of the enterprise" or *Unternehmensinteresse*, see Kübler, *supra* note 121, at 439–40.

130. For Germany, see, e.g., Philipp Klages, *The Contractual Turn: How Legal Experts Shaped Corporate Governance Reforms in Germany*, 11 SOCIO-ECON. REV. 159 (2013) (describing the ascendency of contractarian arguments in German corporate law since about 1990); Markus Roth, *Employee Participation, Corporate Governance and the Firm: A Transatlantic View Focused on Occupational Pensions and Co-Determination*, 11 EUR. BUS. ORG. L. REV. 51, 63–64 (2010) (suggesting a trend towards "enlightened shareholder value"). During the same period, scholars began to identify a trend toward international convergence in corporate governance. *E.g.*, Hansmann & Kraakman, *supra* note 83, at 441.

131. *E.g.*, Dominique Schmidt, *De l'intérêt commun des associés* [The Common Interest of Shareholders], 68 LA SEMAINE JURIDIQUE [JCP] 440, 440–41 (1994); *see also* DOMINIQUE SCHMIDT, LES CONFLITS D'INTERETS DANS LA SOCIETE ANONYME 11–12 (2d ed. 2004) (criticizing the prevailing interpretation of *intérêt social* as being too friendly to controlling shareholders).

132. *E.g.*, Andrew Keay, *Section 172(1) of the Companies Act 2006: An Interpretation and Assessment*, 28 COMPANY LAW. 106, 109 (2007) (describing the former section 309 as a "lame duck, and next to useless").

133. Section 172(1) of the Companies Act 2006 provides an entire list of stakeholder interests that must be considered, but clarifies that they must do so "to promote the success of the company for the benefit of its members as a whole." Companies Act, 2006, c. 46, § 172 (U.K.).

134. *See* Ahern, *supra* note 17, at 121 (coining the difference between "nominated directors," for whom responsibility to the nominator ceases upon nomination and "nominee directors").

utory law. In the United States, the courts have long stated that directors owe an "undivided and unselfish loyalty to the corporation."[135]

In the United Kingdom, the common law originally formulated that directors owed their duties to "the company"; the same language has been incorporated into section 170(1) Companies Act 2006.[136] In Germany and France, despite the fact that both jurisdictions are civil law countries, the language of fiduciary duties is largely judicial rather than codified. The German *Aktiengesetz* does not explicitly state that—either members of the supervisory board or the management board—even have a duty of loyalty, while it explicitly provides for a duty of care.[137] Some explicit statutory duties, such as the duties of confidentiality[138] and, for management board members, not to compete with the firm[139] are today seen as examples of a larger uncodified principle of loyalty.[140] In France, the Commercial Code does not impose a duty of loyalty on directors of any type of company. Case law, however, has developed the concepts of duties of loyalty and fidelity at least since 1996.[141] In both countries, since judges are not conventionally thought to be able to create law, the basis for such concepts originally needed to be found in codified texts. The duty of loyalty was first recognized in the limited context of a sale of shares: the director is required to disclose information impacting the value of the shares (e.g., when a third party is ready to acquire the share for a certain price) to the shareholder willing to sell.[142] The duty not to compete with the firm was later affirmed[143] and is another example of the expanding principle of loyalty.[144] The French Court of Cassation pointed out in its

135. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). Regarding duties to "the corporation and its shareholders," see *supra* note 21 and accompanying text.

136. Companies Act, 2006, c. 46, § 170(1) (U.K.).

137. Aktiengesetz [AktG], Sept. 6, 1965, BGBL. I at 1089, § 93(1) (Ger.).

138. *Id.*

139. *Id.* § 88(1).

140. *E.g.*, HOPT, *supra* note 127, §§ 93 para. 164; Holger Fleischer, *in* 2 MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, § 93 para. 92 (Gerald Spindler & Eberhard Stilz eds., 2010).

141. Cour de cassation [Cass.] [supreme court for judicial matters] com., Feb. 27, 1996, Bull. civ. IV, No. 94-11.241 (Fr.); *see also* Cass. com. May 12, 2004, Bull. civ. IV, No. 00-15.618 (Fr.); Cass. com., Nov. 15, 2011, Bull. Civ. IV, No. 10-15.049 (Fr.).

142. The duty was first recognized in connection with a director who acquired the shares; it supplemented an action for vitiated consent – Cass. com., Feb. 27, 1996, Bull. civ. IV, No. 94-11.241 (Fr.) and later confirmed and broadened in a case in which the director who was not party to the sale but should have disclosed the existence of parallel negotiations (Cass. com., May 12, 2004, Bull. civ. IV, No. 00-15-618, regularly confirmed, *see* namely Cass. com. Feb. 22, 2005, Bull. civ. IV, No. 01-13.642; Cass. com., Jul. 11, 2006, Bull. civ. IV, No. 05-12.024; Cass. com., Mar. 25, 2010, Bull. civ. IV, No. 08-13.060; Cass. com., Mar. 12, 2013, Bull. civ. IV, No. 12-11.970). Other events likely to influence the price shall also be disclosed (*see* Cour d'appel [CA] [regional court of appeals] Paris, July 4 2003, No. 2001/03919 (initial public offering was contemplated).

143. Cass. com., Feb. 24, 1998, Bull. civ. IV, No. 96-12638.

144. *E.g.*, Cass. com., Nov. 15, 2011, Bull. civ. IV, No. 10-15.049 (corporate opportunities); Thierry Favario, Cass. com. Dec. 18, 2012, 4 DALLOZ 288 (2013) (purchase of the building rented by the corporation); *see also* Chantal Cordier-Vasseur & Claire Decoux-Laroudie, *Le Devoir de loyauté du dirigeant*, 87:1-26 LA SEMAINE JURIDIQUE – EDITION GENERALE [JCP G] 1198 (June 2013); Laure Nurit-Pontier, *Devoir de loyauté*, JURISCLASSEUR, Fascicule 45-10, Feb. 2013. The content of the duty of loyalty imposed to nonexecutive board members remains unclear in case law and could be attenuated on the basis of the function of the considered board member. An author advocates for a full application of the duty not to compete on the basis of a duty to act in the best interest of the company deriv-

official annual activity report that such a duty of loyalty derives from the fact that directors are expected to act in conformity with the corporate interest, as well as to respect an equal treatment between shareholders.[145] Violations of the duty of loyalty seem to be characterized by circumstances in which a director was directly or indirectly interested in the sale.[146] The basis of the legal recognition of the duty of loyalty remains unclear in the case law. A specific liability regime applies to directors, as provided for in the Code of Commerce.[147] Pursuant to these provisions, a director can be found liable for violations of statutory requirements, articles of incorporation, or for mismanagement (*faute de gestion*).[148] The duty of loyalty appears to remain outside the scope of this specific liability regime and is traditionally enforced on the basis of the general provision on liability of the parties under contract law.[149] Academic commentators have persuasively suggested that the power detained by the director is the source of the duty of loyalty imposed upon her (rather than the good faith requirement in contract enforcement).[150] The reason is that the duty does not follow from an agreement for the sale of shares, or the law of mandate.[151] Rather, it flows from the status of directors who are not purely agents, but also corporate organs whose functions are defined by statute.[152] This interpretation of French law is inspired by the notion of fiduciary duties as developed in common law jurisdictions.[153]

All of the corporate objectives mentioned—and all of the jurisdictions discussed—have one thing in common: Courts and legal commentators have consistently stated that directors have uniform duties.[154] In Germany, members of the management board are seen as trustees of other people's assets, from which a fiduciary duty naturally flows,[155] and

ing from the information individually held by directors from their collective status as members of a corporate organ. KARINE GREVAIN-LEMERCIER, LE DEVOIR DE LOYAUTE EN DROIT DES SOCIETES 94–95 (2013). This conception is backed by soft law instruments. *See* INSTITUT FRANÇAIS DES ADMINISTRATEURS, NOTE DE SYNTHESE DE LA COMMISSION DEONTOLOGIQUE DE L'IFA: ADMINISTRATEURS ET CONFLITS D'INTERETS (Nov. 2010).

145. RAPPORT DE LA COUR DE CASSATION 1996 [1996 Annual Report of the Court of Cassation] 312–13.

146. This remains true though certain cases do not point this out, see Cass. com., Mar. 12, 2013, Bull. civ. IV, No. 12-11.970.

147. CODE DE COMMERCE [C. COM.] art L. 223-22, L. 225-251, L. 227-7 (Fr.).

148. *Id.* L. 225-251.

149. Which is provided for at CODE CIVIL [C. CIV.] art. 1182. *E.g.*, Cass. com., Mar. 12, 2013, Bull. civ. IV, No. 12-11.970. Since 2010, case law is more ambiguous and special provisions are regularly invoked in connection with the duty of loyalty. *See* Cass. com., Nov. 15, 2011, Bull. Civ. IV, No. 10-15.049 (Fr.).

150. CODE CIVIL [C. CIV.] art. 1134 para. 3.

151. *Id.* (imposing on agent a duty of good faith).

152. Hervé Le Nabasque, *Le développement du devoir de loyauté en droit des sociétés,* 52 RTD COM. 273 (1999).

153. *See* Jean-Jacques Daigre, *Le petit air anglais du devoir de loyauté du dirigeant*, *in* LE JUGE ET LE DROIT DE L'ECONOMIE – MELANGES EN L'HONNEUR DE PIERRE BEZARD 79–86 (Marie-Charlotte Piniot et al. eds., 2002).

154. For Germany, see HABERSACK, *supra* note 40, § 116 para. 11.

155. Fleischer, *supra* note 141, § 93 para. 92.

the same applies to members of the supervisory board by virtue of their membership in a body with monitoring and decision making functions.[156]

In France, board members' power to impose decisions that impact shareholders and the corporation is thought to give rise to a standard of behavior reflecting the specificity of the relationship. In recent years, French law has progressed from board-level collective duties to individual directors' duties.[157] Traditionally, the board had been considered liable only on a collective basis.[158] In March 2010, however, the Court of Cassation recognized that a director may be held liable on a personal level in the event such director failed to oppose a decision taken in breach of the corporate interest.[159]

In the United States, as Simone Sepe puts it, "once a director has been elected to a corporation's board, she owes undivided loyalty to all the shareholders of that corporation—regardless of how she was nominated or by whom."[160] The Delaware Chancery Court in 1987 explicitly ruled out "a special duty on the part of directors elected by a special class to the class electing them."[161] In the recent case of *In re Trados Shareholder Litigation,* the court declined to apply the business judgment rule to the decisions of directors affiliated to a venture capitalist.[162] The majority of directors had approved a merger in which their sponsor, by virtue of holding preferred stock, captured all of the residual value of the firm, while nothing remained for common stockholders.[163]

Similarly, the U.K. Companies Act clearly mentions only the company as the beneficiary of fiduciary duties.[164] There is an expectation that directors will act in a manner that is in accordance with the best interest of the company.[165] The common law has so far rejected the idea that directors might have duties to individual shareholders since this would undermine "the collective nature of the shareholders' association in a company."[166] The courts have recognized that individual directors may owe duties to shareholders on independent grounds, indicating "a special fac-

156. *E.g.*, HOPT & ROTH, *supra* note 59, § 116 para. 173.

157. Paul Le Cannu, *La faute individuelle des membres d'un organe social collectif*, REV. DES SOCIÉTÉS 304 (2010).

158. *Id.*

159. Cass. com., Mar. 30, 2010, Bull. Civ. IV, No. 08-17.841; Le Cannu, *supra* note 158; Paul Le Cannu & Bruno Dondero*, La présomption de faute pesant sur l'administrateur qui participe à une décision fautive du conseil d'administration*, RTD COM. 377 (2010).

160. Sepe, *supra* note 37, at 340 (footnotes omitted) (discussing directors nominated by unionized workers).

161. Phillips v. Insituform of N. Am., Inc., No. 9173, 1987 WL 16285, at *8 (Del. Ch. Aug. 27, 1987).

162. *In re* Trados Inc. S'holder Litig., No. 1512-CC, 2009 WL 2225958, at *7 (Del. Ch. July 24, 2009).

163. *Id.* at *6. Sepe provides an excellent summary, *supra* note 37, at 341–42. A similar hypothetical is described by Veasey & Di Guglielmo, *supra* note 15, at 762. In such a case, the directors and the venture capitalist could still show that the transaction met the "entire fairness" standard; however, the burden of proof would be on them and hard to meet. *See* Smith, *supra* note 51, at 63.

164. COMPANIES ACT, 2006, c. 46 §§ 171–77 (U.K.).

165. *See* Ahern, *supra* note 17, at 123.

166. DAVIES, *supra* note 41, ch. 16-5.

tual relationship between the directors and the shareholders in the particular case" as a result of particular dealings on the individual level[167] (e.g., when a shareholder authorizes a director to sell her shares on her behalf to a potential takeover bidder).[168] Such duties, however, would not supersede or alter the directors' duties to the corporation; the fact that a director has been appointed by a specific shareholder does not in itself create a duty to this member of the company.[169]

Under U.K. law, constituency directors are first and foremost characterized as belonging to the broad class of directors, rather than on the basis of their specific appointer.[170] As a consequence, duties based on loyalty owed to the company, such as the duty to avoid conflicts of interest,[171] the duty to promote the success of the company, and the duty to exercise independent judgment, as well as the general duty of loyalty provided for by section 172 (which require directors to keep in mind the success of the company), all described in the Companies Act 2006, are to be discharged in a similar manner by constituency directors and the rest of the board.[172] The codified text reflects this evolution as section 175(4) of the Companies Act 2006 will not characterize an external conflict of interest "if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest."[173]

It has been argued that because the legislature had not strictly defined the concept of "interest" of the company, there was room for interpretation, as well as taking into consideration the circumstances of a given director's nomination.[174] Yet, the Companies Act of 2006 section 172 emphasizes the promotion of the interest of the company's members as a whole rather than particular interests.[175] Nevertheless, courts have welcomed a nuanced homogeneity and recognized graduated approaches to the duty of constituency directors to act in the best interest of the com-

167. Peskin v. Anderson, [2002] 2 EWCA (Civ.) 326, [33], aff'd, [2001] 1 B.C.L.C. 372 (confirming Percival v. Wright [1902] 2 Ch. 421).

168. Briess v. Woolley, [1954] AC 333 (H.L.) 359; Allen v. Hyett [1914] 30 T.L.R. 444 (P.C.) [7].

169. Hawkes v. Cuddy, [2009] EWCA (Civ) 291, [32].

170. *See* Ahern, *supra* note 17, at 123.

171. *See* Companies Act, 2006, § 172 (detailing general principles of director duties). For a duty to avoid external conflicts of interest, see the Companies Act, 2006, § 175. The rule has been broadly construed and therefore far-reaching. *See* Bray v. Ford, [1896] 44 A.C. (H.L.) at 51 ("[I]t is an inflexible rule of a Court of Equity that a person in a fiduciary position . . . is not, unless otherwise expressly provided . . . allowed to put himself in a position where his interest and duty conflict.").

172. *See* Companies Act, 2006, §§ 172, 175 (silent on differentiating director responsibilities by type of director).

173. Companies Act, 2006, § 175(4). *See* Boardman v. Phipps, [1967] 2 A.C. 46 (H.L.) at 124 (detailing Lord Upjohn's "real sensible possibility of conflict" test); *see also* Boulting v. Association of Cinematograph, Television and Allied Technicians, [1963] 2 Q.B. 606 at 730 (detailing Lord Upjohn's objective test).

174. Pearlie Koh, *The Nominee Director's Tangled Lot*, 2007 SING. J. LEGAL STUD. 148, 156.

175. *See Modern Company Law for a Competitive Economy: the Strategic Framework*, COMPANY LAW REVIEW STEERING GROUP (Department of Trade and Industry 1999) URN 99/654, at para. 5; *see also Modern Company Law for a Competitive Economy: Developing the Framework*, COMPANY LAW REVIEW STEERING GROUP (HMSO, 2000) Department of Trade and Industry, URN 00/656, para. 2.11; BRENDA HANNIGAN & DAN PRENTICE, THE COMPANIES ACT 2006 – A COMMENTARY 32 para. 3.21 (2007).

pany. The absolutist approach tolerates no other interest than the company's. A more nuanced approach allows the interest of the appointer to be taken into account as long as the decision is still made in the best interest of the company. Such primacy of the interests of the company may be contractually softened under the attenuated duty approach.[176]

In Germany, the issue has often been discussed for members of codetermined boards. Employee representatives are supposed to have the same rights and duties irrespective of how they were appointed (although specific duties may arise on an individual level when members are appointed to a committee).[177] The duty of loyalty is said to rule out "one-sided interest group policies of employee representatives."[178] For example, employee representatives have to maintain confidentiality vis-à-vis work councils and unions.[179] The same applies to board members appointed by specific shareholders.[180] The identical treatment of employee representatives has been confirmed in case law of the Federal Court of Justice—at least in dicta—in the context of the duty of confidentiality.[181]

Conflicts of interest have specifically been discussed with respect to appointed or nominated representatives of specific shareholders, who, in exercising their function (including voting on the board), must prioritize the interests of the "enterprise" over others.[182] This applies particularly in takeover situations, where large shareholders may pursue special strate-

176. For a thorough presentation of these approaches, see Ahern, *supra* note 17, at 128.

177. HABERSACK, *supra* note 40*,* § 95 para. 14.

178. HOPT & ROTH, *supra* note 59, § 116 para. 176. Nevertheless, (employee) directors are permitted to participate in a strike, even though most would argue that they are not permitted to organize one. *Id.* at 206–11.

179. HABERSACK, *supra* note 40, § 116 para. 12.

180. *Id.* § 116 para. 13.

181. The court ruled that it cannot be strengthened through a charter provision. Bundesgerichtshof [BGH] [Federal Court of Justice] June 5, 1975, 64 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 325 (Ger.). None of the other reported cases truly concerns directors' duties, but the court simply uses the collegial nature the collective obligation of all supervisory board members to support another point. Bundesgerichtshof [BGH] [Federal Court of Justice] Feb. 25,1982, 83 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 106 (Ger.) (invalidating a provision in a corporate charter stipulating which types of members (employee representatives or not) could serve as the board's chair or deputy chair). Note that under Section 27 MITBESTG, Mitbestimmungsgesetz [MitbestG] [Co-Determination Act], May 4, 1976, BGBL. I at 1153, § 27 (Ger.), this only applies in the first ballot; if candidates do not receive a supermajority of two-thirds, in the second ballot shareholder representatives elect the chair and employee representatives elect the first deputy. Bundesgerichtshof [BGH] [Federal Court of Justice] November 15, 1982, 83 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 293 (Ger.) (finding that individual board members, specifically employee representatives, could not individually use an expert to investigate the companies accounts); Bundesgerichtshof [BGH] [Federal Court of Justice] Nov. 28, 1988, 106 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ], 154 (rejecting the right of individual board members, in this case employee representatives, to enjoin allegedly illegal corporate decisions); *see also* Bundesverfassungsgericht [BVERFG] [Federal Constitutional Court] July 28.1972, 34 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHT [BVERFGE] 103 (Ger.) (German constitutional court stating *obiter* that employee representatives should been seen as representatives of employees only, but are required to consider what the best interest of the enterprise is).

182. HABERSACK, *supra* note 40, at § 116 para. 46. There is no doubt, however, that such directors can also stand in a legal, often fiduciary relationship to their nominator. *E.g.*, Kropff, *supra* note 46, at 844–47.

gic interests.[183] Commentators tend to acknowledge, however, that these interests will typically play a role in defining the "interest of the enterprise."[184] Moreover, it is sometimes suggested that both the interests of shareholders and employees can be taken into account because of their particular bond to the corporation; in the case of employees, this follows from codetermination.[185] Directors, however, are typically required to maintain confidentiality even vis-à-vis their "appointers." The only explicit exception is for board members appointed under special rules by a government entity, who are not required to maintain confidentiality vis-à-vis that particular entity.[186] But even they are not allowed or required to take instructions from the appointing government entity in their role as directors.[187]

In all of these cases, it is generally thought that directors may not be bound (e.g., by contract) to follow instructions from their nominator.[188] Some authors argue that instructions are permissible when they are compatible with the interest of the corporation, in which case there would not be a sanction in the form of liability for the decision anyway.[189] According to what is probably the majority view, instructions are not even possible when the corporation is part of a corporate group.[190] Similarly, while the question is disputed, according to the majority view, directors appointed by the government are not bound by instructions from the appointing entity.[191]

In France, the issue has apparently not frequently been raised; however, it is thought that worker representatives and representatives of the government as members of the board have the same duties as other directors, given that the law does not stipulate otherwise.[192] In other words, the legislator has not defined the notion of "director" in a prescriptive manner.[193] As a consequence, the "director" legal category may hardly be

183. HABERSACK, *supra* note 40, at § 100 para. 66.

184. *Id.*

185. HOPT & ROTH, *supra* note 59, § 93 para. 115.

186. Aktiengesetz [AktG] Stock Corporation Act], Sept. 6 1965, BGBL. at § 394 (Ger.). *See* Weber-Rey & Buckel, *supra* note 60, at 15–18 (discussing a current reform proposal intended to expand the scope of this exception).

187. Weber-Rey & Buckel, *supra* note 60, at 21–22.

188. HABERSACK, *supra* note 40, at § 111 para. 139; Gerald Spindler, KOMMENTAR ZUM AKTIENGESETZ § 111 para. 79 (Gerald Spindler & Eberhard Stiltz eds., 2nd ed. 2010); UWE HÜFFER, AKTIENGESETZ § 101 para. 10 (10th ed. 2012).

189. *E.g.*, Kropff, *supra* note 46, at 848–49. *Contra* HABERSACK, *supra* note 40, at § 101 para. 51.

190. HABERSACK, *supra* note 40, at § 111 para. 139; *see also* Kropff, *supra* note 46, at 854–55 (denying a distinction between nongroup firms and firms in a de facto group). An obvious exception are so called "contractual groups," in which case the dominated group companies must follow the instructions of the controlling entity under the domination agreement (§ 308 AKTG). Contractual groups are rare, however, and subject to a specific legal regime. *See id.* at 855–56 (noting that even in this case, directors must review instructions from a controlling shareholder for their compatibility with the interest of the corporation, but pointing out that it will typically by identical to the interest of the controlling entity, given that the letter is required to reimburse the firm for losses).

191. Regarding the discussion, see HÜFFER, *supra* note 189, § 394 para. 28–30.

192. ANNE CHAVÉRIAT ET AL., MÉMENTO PRATIQUE : SOCIÉTÉS COMMERCIALES, ¶¶ 7985, 8034 (Francis Lefebvre ed., 41st ed. 2009).

193. Executive and nonexecutive directors usually are not distinguished.

considered homogeneous; however, for want of legal distinction and subcategories with specific regimes, homogeneous principles apply.

IV. DIVERSITY IN DIRECTOR ACTION: EFFICIENT AND INEVITABLE?

So far, we have identified a trend in the development of corporate governance toward a greater heterogeneity of directors, but we found that this heterogeneity is not matched by a corresponding shape of directors' duties. Now we try to approach the question whether this situation is tenable from a normative perspective. While mandatory uniform duties almost seem to be a legal and cultural universal, the normative basis for this seems to be limited (Section A). There seem to be good economic reasons, grounded in the theory of incomplete contracts, to permit directors to pursue the interests of their constituency (Section B). Psychological mechanisms even suggest that it may be inevitable for directors to individually act as representatives of their appointers (Section C). And finally, some empirical evidence suggests that the composite nature of the board necessarily affects how corporate decisions are reached at this level (Section D).

A. The Limited Argument for Uniform Duties

Private law imposes fiduciary duties in order to remedy the risk of agency costs deriving from representative relationships.[194] Because every board member participates in the collective decision-making process (decisions as to third party-related transactions being set aside), each is involved in the development of agency cost risks. Moreover, board decisions being collegial, each director enjoys, *de jure*, the same role and responsibility in the decision. As a consequence, it is therefore also expected that every director will have to abide by the same set of fiduciary duties.[195]

The standard law and economics perspective of corporate law supports this explanation: shareholders are generally given residual control rights because they are the firms residual claimants (i.e., since they do not have fixed claims, in contrast to other corporate constituencies, but benefit from excess profits resulting in the form of dividends and a rise in share price, they are said to have better incentives to maximize total welfare in a corporation than all others).[196] This view is connected to the assumption of a fundamental unity of the interest of all shareholders, who,

194. *See* John Armour et al., *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW 37–40 (2d ed. 2009); Luca Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class*, *in* THE ANATOMY OF CORPORATE LAW 55, 79–81 (2d ed. 2009) (describing fiduciary duties as a standard to reduce agency cost in the shareholder-manager relationship).

195. *See* Ahern, *supra* note 17, at 123 (negatively answering the question whether nominee directors have a distinct legal status among directors under U.K. law, and whether they consequently possess distinct legal duties).

196. *E.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 10–11 (1991).

on the most basic level, want to make a profit.[197] Any separate interest of specific shareholders is therefore viewed with suspicion, since it is likely linked with clearly illegitimate conduct such as self-dealing.[198] Nevertheless, this stands in tension with why shareholders sometimes agree to allow another shareholder to put a "constituency director" on the board in an initial agreement, and why some shareholder willingly buy shares in a firm that already have such a term.

One possible explanation could be that law policing explicit self-dealing is not enough to prevent the latter if a constituency director is otherwise allowed to take decisions upon the instruction of her appointer, or primarily with that individual's (or group's) interest in mind. It may be too difficult to distinguish legitimate decisions about corporate policy that a venture capitalist may want to dictate from blatant looting of the firm. If the history of corporate law is any guide, the fear of excessive influence of large and controlling shareholders for their own ends has often been the motivation for strengthening the board of directors vis-à-vis shareholders.

Two very different examples may serve to illustrate this point. First, the venerable English case of *Automatic Self-Cleansing Filter Syndicate, Co., Ltd. v. Cuninghame*[199] is sometimes cited and included in corporate law casebooks for the proposition that every shareholder has the legitimate expectation that the board will apply its independent judgment to the benefit of the corporation as a whole.[200] The message is complicated by the fact that English law in fact did allow shareholders to give binding instructions at this time, but the corporate charter of the firm in question required a supermajority for a resolution.[201] Second, a possibly more obvious case is the debate leading up to the German corporate law reform of 1937 in the 1920s and 1930s, which, at least in part, revolved around problems created by shareholder influence emanating both from controlling shareholders and changing majorities. The new section 70 of the 1937 AktG then prohibited any instructions to the board from being passed in the shareholder meeting.[202]

Thus, one could argue that directors overtly taking instructions from specific shareholders or other constituencies might create strife by bringing conflicts of interest into the boardroom without intermediation. Boards may often pursue the objectives set by those who are able to

197. *E.g.*, George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 105 (2010). *Contra* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power,* 53 UCLA L. REV. 561, 577–93 (2006).

198. Dent, *supra* note 198, at 109–10 (arguing that there are few shareholders who do business with large publicly traded firms).

199. Automatic Self-Cleansing Filter Syndicate, Co. Ltd. v. Cuninghame, [1906] 2 Ch. 34 (Eng.).

200. *Id.* at 43. The case is cited in WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 104–06 (4th ed. 2012).

201. *Cuninghame*, [1906] 2 Ch. at 43.

202. *See* Gelter, *supra* note 116, at 680–93 (surveying the debate and focusing in particular on the influential views of Walther Rathenau).

voice them most strongly in the boardroom. Binding all board members to uniform duties may mitigate this danger.[203]

In addition, such a uniform set of fiduciary duties is standardized in its content from the perspective of the board members, because of the needs these duties address. In any conception of the corporation,[204] including models that do not give exclusive primacy to shareholders, fiduciary duties are intended to protect shareholders (and possibly other interested groups) from individuals taking benefit from the corporation to its detriment. Hence, fiduciary duties may be described as a set of rules designed for the benefit of a *class* of corporate actors.[205] They should therefore represent standards uniformly benefitting such class and not favor one shareholder, or category of shareholders, over the others. Consequently, they are expressed in an undifferentiated manner from the perspective of the obligated individuals. Not surprisingly, they are often identified as "duties of the board": they are expected from the collective entity represented by the board, and only by transition, from the directors in their capacity as board members.

It should be emphasized that the uniform and standard nature of fiduciary duties is compatible with the reality of board nomination. Arguably, acknowledging the fact that board members are nominated via a process that reflects various constituency interests does not eradicate the grounds for uniformity. The law of agency provides that a representative shall act in the interest of the constituency that authorized her.[206] As Leib, Ponet, and Serota explain in reference to the public sphere: a "representative is selected locally and 're-presents' her home district in some senses, but she *also* serves the 'people' and wields power more broadly."[207] The rational for this enlarged duty is that others' interests, vulnerable to her legal power over them, may need to be protected in her activities.[208] These authors conclude that "fiduciary duties may apply to a shifting constellation of beneficiaries" at different times.[209] In other words, nomination by a constituency indicates *a moment* in the director's experience, but does not participate in drawing the limit of the director's fiduciary duties spectrum.

203. Austrian corporate governance, which traditionally has combined a German corporate law (based closely on the German 1937 Act) with French-style government ownership, provides another example: The independent duty of the board of directors to the firm enshrined in the Austrian *Aktiengesetz* was sometimes used by managers in the media to fend off political influence.

204. I.e., irrespective of whether the model revolves around managerial or shareholder primacy, shareholder or stakeholder wealth maximization.

205. Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 305 (1993) (describing fiduciary duty as something owed to multiple sets (or classes) of stakeholders).

206. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006) ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship.").

207. Ethan J. Leib et al., *Mapping Public Fiduciary* Relationships, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 388, 401 (Andrew S. Gold & Paul B. Miller eds., 2014) (emphasis added).

208. *Id.* at 398–99.

209. *Id.* at 401.

One could argue that there are other collective bodies, such as juries or the U.S. Supreme Court, where it is often considered important for individuals from diverse personal backgrounds to be represented.[210] In these cases, however, these individuals are obviously not intended to represent specific interests, such as by advancing the interests of a specific member of the same group in jury or judicial deliberations. By contrast, debates on the board of directors between directors representing different groups are more accurately characterized as negotiation than deliberation; in this case, the constituency director is typically appointed precisely with the objective of representing a specific group or individual.

An argument in favor of more homogeneity within the board has been made, and it calls for homogeneous duties as well. From an efficiency perspective, a more homogeneous board may be superior since interests of different groups will often conflict.[211] Such a view may, however, be questioned in the light of behavioral findings: groups tend to focus on the portion of knowledge that is already shared rather than engage in more creative thinking.[212] When groups are cohesive, this bias creates a risk of groupthink deriving from a "psychological drive for consensus at any cost that suppresses dissent and appraisal of alternatives in cohesive decision-making groups."[213] This means that, as to their skills, directors should meet certain shared criteria enabling a more fruitful conversation and decision-making process. Pursuant to this pragmatic logic, there is, *conversely*, a better case for directors to only owe uniform duties to the shareholders. Any acknowledged diversity in duties is a factor of heterogeneity within the board and may weaken its functioning.

In practice, however, the screening of related party transactions and other questions relating to conflict of interests issues (e.g., self-dealing, unfair competition, capture of corporate opportunities) represents an important dimension in the duty of loyalty besides the more traditional information obligations towards the shareholders. Jurisdictions mainly assign responsibility for ensuring compliance with related party transactions law to the disinterested directors only—and it is not the same individuals that are considered disinterested directors for each and every related party transaction. In other words, the uniform standards strategy operates in conjunction with the diverse constituency strategy,[214] the latter providing for duties that are, in essence, diverse and specific to the trust relationship.

B. Economic Theory: Nonuniform Duties as a Solution to Incomplete

210. For example, members of different genders or ethnic identity groups.

211. Stephen M. Bainbridge, *Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency,* 1 J. BUS. & TECH. L. 335 (2007).

212. IRVING. L. JANIS, VICTIMS OF GROUPTHINK: A PSYCHOLOGICAL STUDY OF FOREIGN-POLICY DECISIONS AND FIASCOES (1972).

213. *Id.* at 8. A famous example of groupthink is the 1961 invasion of Cuba and the fiasco to which it amounted.

214. *See* Luca Enriques et al., *Related-Party Transactions*, *in* THE ANATOMY OF CORPORATE LAW 153, 173–74 (2d ed. 2009).

Contracts

The question remains whether these arguments justify a uniform duty as mandatory law, as is currently the case (at least in theory) in all of the jurisdictions surveyed here. The economic theory of contracts, specifically the theory of incomplete contracts, provides a major argument for at least permitting firms to opt out of uniform duties in their charter. Insights from behavioral theory tend to support such a proposal, as it builds upon the likely behavior of directors, instead of ignoring this behavior.

Generally, somebody entering into a long-term relationship will typically require some contractual guarantees to protect her investment. Economic theory, however, has long recognized that long-term contracts are typically incomplete. If two parties seek to enter into a long-term business relationship with each other, each of them will be expected to contribute certain resources, such as financial resources and skills. Both will want to benefit from the profits that their business is going to produce, and presumably they will want to make sure that each of them will, in the future, continue to have the incentive to contribute. The assets contributed are often not easily transferable to other uses, which makes each of the two parties vulnerable.

Traditional Chicago-style economic analysis of corporate law assumes that most groups dealing with the corporation are adequately protected by long-term contracts, thus protecting them from opportunism by shareholders or managers.[215] Only shareholders—as the residual claimants of the corporation—are not, which is why they have residual control rights, including the right to vote for directors.[216] Complete protection through contracts, however, is likely not feasible in many (if not most) cases. Contracts that fully protect such groups would have to be, in economic parlance, "complete contingent" ones, thus—in theory—determining payoffs for all parties for each possible state of the world.[217] Transaction cost economics has long recognized that there are important impediments to this, including information asymmetry, opportunism, and bounded rationality.[218] Other terms are not included in contracts because the parties cannot observe, and courts cannot verify them *ex post*. It is, for example, hard to objectively anticipate and measure "the demand for cars, or the degree of innovation, the extent of government regulation, or

215. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 333–38 (1985) (showing why the contract method protects other stakeholders in firms).

216. *Id.* at 10–11 (discussing the role of shareholders as residual claimants).

217. *See, e.g.*, Hart, *supra* note 206, at 305 (1993) (discussing full protection through complete contracts as a necessary assumption underlying a narrow interpretation of fiduciary duty); Alan Schwartz, *Incomplete Contracts*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 277 (Peter Newman ed., 1999) (defining incomplete contracts). Complete contingent contracts would have to include payoffs for all parties involved depending on numerous exogenous factors, such as market demand, actions of competitors, legal regulation, and many others.

218. WILLIAMSON, *supra* note 216, at 43–55 1985; *see also* OLIVER HART, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE 23 (1995).

the actions of competitors."[219] In short, transaction costs rule out contracts stipulating payoffs for each party under all possible circumstances.

The "property rights" or "incomplete contracts" approach of the theory of the firm developed by Oliver Hart and his coauthors emphasizes the importance of who "owns" an asset, i.e., who has residual control over it.[220] In those states of the world not specified by contract, decisions will be made by the owner, who may have the opportunity to appropriate the other parties' rents.[221] These may induce the other parties to underinvest. Rajan and Zingales subsequently suggested that not only those parties not in control have an incentive to underinvest, but also the owner, since the illiquid nature of her asset makes it more difficult to hold up other parties.[222] Building on this, Blair and Stout have argued that in large, publicly traded corporations in the United States, the board of directors thus typically takes the role of "mediating hierarch," balancing the interests of various groups and permitting all of them to make specific investment in the corporation.[223]

While a "neutral" board may be a solution to this governance problem in a publicly traded corporation with diffuse ownership, this will likely not be the case in situations where "constituency directors" are on the board. The explicit representation of different constituencies (including both shareholders and others) creates a structure where "ownership" (in Hart's terminology) or "power" (in Rajan & Zingales' terminology) is shared between all of the participants.[224] Given the inevitable incompleteness of contracts, a large shareholder such as a venture capitalist, whose investment in the company is specific in the sense that it is difficult to withdraw, is in a vulnerable position. This investor will therefore seek representation in the process that determines how rents produced by the corporation are distributed *ex post* in situations that were not explicitly stipulated *ex ante*. Otherwise, she might not expose herself to this risk.

Similarly, from an economic perspective, the rationale for employee representation on the board of directors is typically that workers often make firm-specific human capital investments in skills that are difficult to transfer to another job.[225] Employees may be more inclined to invest in

219. HART, *supra* note 220, at 24.

220. *See* Hart, *supra* note 206, at 305–13.

221. HART, *supra* note 220, at 29–33.

222. Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q. J. ECON. 387, 410 (1998).

223. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 278–81 (1999); Margaret M. Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, 7 EUR. BUS. ORG. L. REV. 473, 492 (2006); *see also* Hart, *supra* note 206, at 306–07 (suggesting that a fiduciary duty that considers stakeholder interests could be used to sustain implicit contracts).

224. Hart, *supra* note 206, at 303; Rajan & Zingales, *supra* note 224, at 387.

225. Larry Fauver & Michael E. Fuerst, *Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards,* 82 J. FIN. ECON. 673, 679 (2006). Regarding specific investment by employees, see generally HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 26 (1996); Egon Franck et al., *Specific Human Capital as a Source of Superior Team Performance*, 63 SCHMALENBACH BUS. REV. 376, 377–81 (2011) (discussing team-specific capital); James M. Malcolmson, *Individual Employment Contracts*, *in* 3 HANDBOOK OF LABOR ECONOMICS 2291, 2311–37 (Orley Aschenfelter & David Card eds., 1999) (reviewing the labor economics literature on contrac-

specific skills if they are less exposed to threats of opportunistic wage negotiations,[226] the termination of pension plans,[227] or a default on implicit expectations on career opportunities.[228] German codetermination may thus play a role in protecting employees against shareholder opportunism,[229] and thus is a part of a socioeconomic model that helps German workers continue to develop specific skills. In this view, workers might avoid specializing their human capital if they were less protected by shared participation in corporate decision making, and instead had to rely on private and collective contracts, as well as merely on specific rules of employment law.

Discussing "constituency directors" under U.S. corporate law, Simone Sepe criticizes that boards, thus, do not have the discretion to give anything to the "sponsor" of a specific director that has not otherwise been explicitly bargained for.[230] Consequently, if directors may not represent the interests of their sponsors, but have to strictly pursue the interests of "the corporation" or *all* of its shareholders, and if this duty is strictly enforced, it is difficult to address the long-term contracting problem outlined here with governance rights. A large financial investor who might bargain for a nominee director on the board will have to resort to explicit contractual stipulation of her rights and duties under all foreseeable future situations. The problem should now be immediately apparent: Given that long-term contracts are necessarily incomplete, a potential investor's interest will often not be sufficiently protected. This might discourage investment or require investors to charge a higher risk premium. A similar argument may be made for workers. Workers may be reluctant to invest in firm-specific skills without directors representing them. Contracts, or even strong employment law, may not be an adequate substitute given the incomplete contracts problem. This argument applies analogously to mandatory legal rules such as those governing the employment relationship. Employment law often uses bright-line rules and is thus often unable to adjust to all possible future contingencies.

Along the same lines, the commercial reality of the situation shared by nominee directors calls for its legal recognition in the context of contract interpretation. It has been pointed out that, where a company's articles provide for a right of shareholders to nominate a director, they should be read as providing for the following implicit understanding: that

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tual protection of specific investment); Stewart J. Schwab, *Life-Cycle Justice: Accommodating Just Cause and Employment at Will*, 92 MICH. L. REV. 8, 13 (1993).

226. Thomas Eger, *Opportunistic Termination of Employment Contracts and Legal Protection Against Dismissal in Germany and the USA*, 23 INT'L REV. L. & ECON. 381, 384–85 (2004).

227. *See also* Gelter, *supra* note 92, at 937–41.

228. *See generally* John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 74–81 (1986) (discussing implicit contracts).

229. *E.g.*, John T. Addison & Claus Schnabel, *Worker Directors: A German Product that Did Not Export?*, 50 INDUS. REL. 354, 358 (2011); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 169 (2009).

230. Sepe, *supra* note 37, at 343–46.

it is accepted by the parties that a special responsibility towards a shareholder is in the interests of the company as a whole.[231] If the members of the company provided for the appointment of these directors, then they most likely must have done so to represent their nominators' interests. Thus, it would seem contrary to the intention of the contracting parties to disregard these interests.

C. The Impact of Directors' Individual Characteristics on Their Behavior

Economic theory aside, it is recognized that various cognitive factors are likely to impact directors' behavior: *volens nolens*, that directors are appointed agents impacts their behavior.[232]

First, directors may have an incentive to be perceived as maximizing shareholders' welfare. In practice, they are likely to take into account the fact that shareholders' rationality is bounded in order to achieve this aim. More precisely, as Aviram points out, they can choose to strategically target risks that shareholders usually overestimate.[233] Such opportunistic behavior, or "bias arbitrage," corresponds to a situation in which a director identifies that shareholders, or some of them, overestimate a risk and, as a consequence, take actions to mitigate this overestimated risk.[234] As a consequence, perceived loyalty is also overestimated. The greater the overestimation of the risk, the greater the benefit to the agent.[235] Principals are deluded as to the reason for the reduction in their perceived risk: they tend to believe it derives from the agent's action rather than correction to their perception of risk.[236]

Directors may engage in diversified bias arbitrage reflecting heterogeneous perceptions of risks among shareholders. This type of arbitrage does not *per se* violate fiduciary duties as long as it is compatible with the business judgment rule, i.e., does not amount to a conflict of interest.[237] Generally speaking, arbitrage decisions will increase the shareholders' welfare as it corrects their risk overestimation, which is likely to trigger suboptimal actions (e.g., excessive avoidance of investment, excessive request for regulation, etc.). Often, however, they will not maximize welfare, but courts are unlikely to question this.[238]

Cognitive biases not only affect the perception of shareholders, but they also tend to affect the directors' behaviors as well. Though board

231. *See* Elizabeth Boros, *The Duties of Nominee and Multiple Directors Part II*, 11 COMP. LAW. 6, 6–10 (1990); Elizabeth Boros, *The Duties of Nominee and Multiple Directors*, 10 COMP. LAW. 211, 211 (1989); Philip P. Crutchfield, *Nominee Directors: The Law and Commercial Reality—Time for a Change*, 12 COMP. LAW. 136 (1991); Pey-Woan Lee, *Serving Two Masters—The Dual Loyalties of the Nominee Director in Corporate Groups*, 2003 J. BUS. L. 449, 452.

232. Amitai Aviram, *What do Corporate Directors Maximize? (Not Quite What Everybody Thinks)*, 6 J. INST. ECON. 47, 47–53 (2010).

233. *Id.* at 49.

234. *Id.* at 48.

235. *Id.* at 49.

236. *Id.*

237. *Id.* at 52–53.

238. *Id.*

members may not deliberately make a decision to take into account their personal loyalty, there are reasons to believe that, in certain circumstances, such loyalty will distort behaviors on the basis of psychological mechanisms. A director willing to discharge her duties according to the principle of "uniform loyalty" may find herself in a difficult position due to her own psychological biases of which she is often not aware. It is particularly interesting to observe that such a phenomenon is prone to happen in the context of what we describe as an incomplete contract situation.

We must first acknowledge that empirical evidence in the context of corporate law and corporate boards is limited and focuses on the independence of directors,[239] and not, as we do, on the question whether directors represent a specific constituency outside the corporation. Moreover, for some constituency directors, it is clearly difficult to empirically disentangle the effects of ownership stakes or credit relationships as such on the one hand, and representation on the board on the other.[240]

There is some empirical evidence, however, that heterogeneity in the profile of directors sitting on the board has an impact on the corporation. Some studies are of interest; in particular, some experiments suggest that bank representatives have effects on various corporate characteristics such as capital structure.[241] In addition, in the area of employee directors, the literature on German codetermination provides some evidence that suggests that they do.[242] A well-known study by Gorton and Schmid, often cited by critics of the practice, found that firms subject to the strictest regime (where fifty percent of seats are held by employees) traded at a thirty-one percent discount to firms where employees only held one-third of the seats on the board.[243] A paper by Fauver and Fuerst, however, found a positive effect of the less intrusive regime (one-third of board members), but the results were industry-specific.[244] A third study by FitzRoy and Kraft found that the introduction of codetermination in 1976 slightly increased productivity.[245] This is clearly not the place to provide an overall evaluation of employee participation systems. Moreover, we do not have all of the necessary variables, such as the welfare pro-

239. *See, e.g.*, Sanjai Bhagat & Roberta Romano, *Empirical Studies of Corporate Law*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 945, 992–95 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (surveying the literature).

240. *See* Gorton & Schmid, *supra* note 54, at 66 (not using bank representation on the board as an explanatory variable because of concerns of endogeneity).

241. Daniel T. Byrd & Mark S. Mizruchi, *Bankers on the Board and the Debt Ratio of Firms*, 11 J. CORP. FIN. 129, 134 (2005).

242. For a more comprehensive review of the empirical evidence, see Addison & Schnabel, *supra* note 231, at 361–69.

243. Gary Gorton & Frank A. Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS'N 863, 895 (2004).

244. Fauver & Fuerst, *supra* note 227, at 677.

245. Felix FitzRoy & Kornelius Kraft, *Co-determination, Efficiency and Productivity*, 43 BRIT. J. INDUS. REL. 233, 234 (2005); *see also* Thomas Zwick, *Employee Participation and Productivity*, 11 LAB. ECON. 715, 720 (2004) (finding an increase in productivity resulting from shop-floor employee participation).

duced by corporations for employees. Even if "full" codetermination has negative effects for shareholders in Gorton & Schmid's study, this may be outweighed by unobserved gains for employees. The less intrusive regime may be beneficial for the shareholders of some firms, even if we do not take the effects on workers into account. By contrast, a study on American firms where employees hold considerable stock (and thus control rights) suggests that employees benefit while share value suffers.[246] In any event, the evidence seems to be clear that employee directors make a difference overall. Similarly, a study by Adams et al., in which the authors confronted directors with several hypotheticals, found that Swedish employee representatives were more likely to side with employees against shareholders where interests collide.[247]

Having established that some consequences derive from the presence of the board of directors from a certain type within the typology, a further step would consist of assessing more precisely what specific behavior may be expected from each type of director. There are hardly any experiments from which direct conclusions may be drawn. On a more theoretical level, however, some hypotheses may be grounded on more general behavioral studies.

D. Effects of Heterogeneity on Collective Decision Making

The board is built as a group of individuals, which suggests a collegial corporate decision making process.[248] Social psychology insights may help understand the decision process within such a group—and point to potential consequences deriving from the specifically diverse collection of individuals comprising such groups. In a widely cited article,[249] Stephen Bainbridge notes the specific issue raised by the board "as a team production problem"[250] and that corporate law, therefore, has a "strong emphasis on collective decision making."[251]

From a legal standpoint, the adequacy of the *decision-making process* tends to receive more emphasis as the review of substantive outcomes decreases in corporate law. This trend is to be understood as corollary to (1) the need for flexibility, risk taking, etc., and (2) the inability

246. Olubunmi Faleye et al., *When Labor Has a Voice in Corporate Governance*, 41 J. FIN. & QUANT. ANAL. 489, 493 (2006).

247. Renée B. Adams et al., *Shareholders and Stakeholders: How do Directors Decide?*, 32 STRATEGIC MGMT. J. 1331, 1338 (2011).

248. Collegial processes are not restricted to boards but observable in adjudication by a panel of judges, decision by juries, agency rule making, etc. *See* Mark Seidenfeld, *Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking*, 87 CORNELL L. REV. 486, 517 (2002); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 95 (2000); Cass R. Sunstein, *Group Judgments: Statistical Means, Deliberation, and Information Markets*, 80 N.Y.U. L. REV. 962, 979–80 (2005); Cass R. Sunstein, *The Law of Group Polarization*, 10 J. POL. PHIL. 175, 175 (2002).

249. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002).

250. *Id.* at 2.

251. *Id.* at 19.

of courts to second-guess business decisions. Therefore, the law needs to be aware of current empirical research on decision making so that it may take into account biases and other psychological dimensions that are likely to defeat specific legal purposes. As is often stressed, empirical studies are not likely to answer questions relevant to the law directly: in a complex world, in which more than one cause produces outcomes, developing a theory apt at providing a reliable guide to policy seems whimsical. Empirical studies, however, may provide value by ruling out certain arguments.[252]

During the past decade, a growing body of conclusions as to decision making within groups have become more well-known and defeated the traditional idea that corporate law's emphasis on collective decision making by the board would have an efficiency rationale.[253] The treatment of empirical research must be systematic in order to be meaningful rather than anecdotal, and only robust findings should be considered. From a methodological standpoint, lawyers are therefore advised to rely primarily on meta-analysis and to qualify conclusions they may reach.[254] Given these caveats, it is worth noting that groups generate productivity losses in terms of the quality of decisions[255] compared to aggregate performance across individuals composing such a group for a variety of reasons, including the fact that incentives are low, costs are high, and individuals feel dispensable.[256] In other words, following the motivational effect, only simple tasks requiring every group member's input benefit from the collegial process: such tasks are, however, quite limited at the board level. It is equally well established that groups reach better decisions in situations where their members are individually accountable.[257] The aggregation of information enables a collective decision to exceed the average decision quality a group contributor would reach on her own, but it rarely enables the best contributor's view to be followed. In other words, groups tend to deteriorate decision quality via motivational, informational, polarization, and bias effects,[258] unless specific procedural precautions are taken. These observations are of general interest to the functioning of boards of directors. The more specific issues linked to the heterogeneity of directors within the board require to turn to other findings in social psychology. The interplay between individuals and the group to which they belong at the stage of decision making is of specific interest. How does it model the interaction between directors making decisions in their capaci-

252. Jeffrey J. Rachlinksi, *Evidence-Based Law*, 96 CORNELL L. REV. 901, 919 (2011).

253. *See* Bainbridge, *supra* note 251, at 19 ("Corporate law's strong emphasis on collective decisionmaking by the board thus seems to have a compelling efficiency rationale.").

254. On such precautions, see Hanjo Hamann, *Unpacking the Board A Comparative and Empirical Perspective on Groups in Corporate Decision-Making*, 11 BERKELEY BUS. L.J. 1, 27 (2014).

255. *See* Norbert. L. Kerr & R. Scott Tindale, *Group Performance and Decision Making*, 55 ANN. REV. PSYCH. 623, 631 (2004).

256. *Id.* at 628–29.

257. *Id.*

258. For a critical review of empirical studies relating to each dimension, see Hamann, *supra* note 256, at 27.

ty as board members? We may first stress that group decision making has proven a complicated process. So far, no single model has been established that integrates all of the main factors that have been identified.[259] Among such factors, however, and besides, the characteristics of the decision (such as its importance or time pressure) and the context, the structure of the group plays a recognized role. Psychologists distinguish group decision making processes in particular along two dimensions, namely the degree of cohesiveness and homogeneity within the group. This characteristic influences the rules according to which decisions are taken. Majority rule is only one option. A weighted linear combination model better explains decision making processes in those cases that (1) require an active consensus-building, and (2) where possible results come along a continuum. In these situations, the opinions of those group members positioned closer to the group's center will receive more weight.[260] It is thereby implied that group members are influential in direct proportion to how strongly they represent the group. In other words, as a person becomes more cognitively central, the person's influence increases because of the perceived expertise that results from the group agreement.

In relation to our research question, this finding tends to indicate that board members with a recognized technical expertise have good chances to be more influential in connection with decision making at the board table relating to their expertise. It appears that the potentially moderating influence of people who disagree is very much diluted.[261] This may, in turn, indicate that, in cases where there is a dominant group, employee directors and other directors nominated for reasons pertaining to their belonging to a particular group of stakeholders may only have a marginal influence in decision making.

Group decision making can polarize individual attitudes as people learn about the attitudes of other members in the group and may tend to conform to the group prototype.[262] As a consequence, decisions taken in a group may be riskier than the original preferences of the individual members in the group.[263] Such findings tend to nuance the effectiveness of subtle networks of power and counter powers that boards sometimes try to achieve.

In particular, deference bias may induce distorted participation of board members in the collective decision-making process at the board table. In order to enable independence in board's decision making, a thorough structural corporate governance design is required. For in-

259. Ramon J. Aldag & Sally Riggs Fuller, *Beyond Fiasco: A Reappraisal of the Groupthink Phenomenon and a New Model of Group Decision Processes*, 113 PSYCHOL. BULL. 533 (1993).

260. J.H. Davis et al., *The Committee Charge, Framing Interpersonal Agreement, and Consensus Models of Group Quantitative Judgment*, 72 ORG. BEHAV. & HUM. DEC. PROC. 137, 141 (1997).

261. SUSAN T. FISKE, SOCIAL BEINGS: CORE MOTIVES APPROACH TO SOCIAL PSYCHOLOGY 520 (2d ed. 2004). This is consistent with the findings of group polarization.

262. *Id.* at 518.

263. See the classic experiment, Michael A. Wallach et al., *Diffusion of Responsibility and Level of Risk Taking in Groups*, 68 J. ABNORMAL & SOC. PSYCH. 263, 263 (1964).

stance, Randall Morck favors separating the chair and CEO functions in corporate governance.[264] According to his analysis, directors are likely to replicate submission to authority ("obedience" commands) demonstrated in the classic 1974 social psychology experiments by Stanley Milgram.[265] Such excessive deference to a director's influence calls for a counter power that the separation of functions enables. Inferences from psychological findings are, however, less robust when, as in the Milgram experiment presented above, they are not designed in the corporate context.

V. THE CONSEQUENCES OF HETEROGENEOUS LOYALTIES

Having concluded that the heterogeneity of board members will likely lead to different directors pursuing the interests of their respective "constituency" in practice, we now turn to policy: Should the law continue to prescribe uniform fiduciary duties? As we explained above, corporate governance systems relying on concentrated ownership, a larger role of banks, the government, and labor have long relied on directors representing these interests *de facto*,[266] even if their diverse loyalties have not received formal recognition.[267] Should these jurisdictions give more overt recognition to this directorial role? Should the United States, where representative directors correspond to a growing role of strategic, larger investors, give more recognition?[268]

For the purpose of our discussion, it is useful to pay attention to directors' behaviors in two set of circumstances. One relates to the way such directors take part in the collective decision-making process and deal with conflict of interests. The second set relates to whether directors individually should be permitted to share nonpublic confidential information with their "sponsor." We suggest that decision making may not be virtually a nonissue because the courts hardly police the substantive content of decision making across jurisdictions; the practical content of the "interest of the corporation" is thus often determined by the board itself (Section A). As to confidentiality, we suggest that firms should be allowed to opt out of it (Section B).

A. Do Heterogeneous Loyalties Trump Uniform Duties in Corporate Decision Making?

If empirical evidence shows that both the identity and the directors' provenance impact decisions they are likely to make, are their fiduciary duties, specifically the elusive ultimate objective of the corporation, even

264. *See* Randall Morck, *Behavioral Finance in Corporate Governance: Economics and Ethics of the Devil's Advocate*, 12 J. MGMT. & GOVERNANCE 179, 179 (2008).
265. *See generally* STANLEY MILGRAM, OBEDIENCE TO AUTHORITY: AN EXPERIMENTAL VIEW (1974).
266. *See supra* Part II.
267. *See supra* Part II.A.
268. *See supra* Part II.A.

relevant for conflicts of interest between different nominators that constituency directors represent? One possibility is that directors matter little when they lack a shared purpose as constituency directors do, particularly vis-à-vis a management that is clear about its plans.[269] Empirical evidence, however, and the fact that constituency directors are sometimes bargained for, suggest that at least some directors affect the distributive outcomes for different constituencies.

As discussed above, there is little clarity about corporate purpose across jurisdictions. In addition, there is little enforcement relative to the objective directors are expected to pursue, which supports the paradox that this Article has attempted to decipher. Most of the conflicts of interest that likely come up between various constituencies represented by different directors are not likely to be reviewed all that intensely by the courts. For example, the shareholder primacy norm in the United States is generally not considered to be enforced with any vigor. Robert Clark argues that Henry Ford's mistake in the celebrated case of *Dodge v. Ford* was not his decision as such, but his purported social motivation.[270] Most decisions that potentially redistribute between shareholders and workers, such as what benefits are offered to employees, whether a plant is to be closed, or how hard to bargain with the union, will typically be protected by the business judgment rule in the United States.[271] The same can be said for the main conflict of interest between shareholders and creditors, namely what level of risk is appropriate for the firm (generally, higher risk redistributes from creditors to shareholders). As Baird and Henderson explain, "the board can even take actions that deliberately benefit creditors at the expense of shareholders, so long as the decision is based in facts, well considered, in good faith, and not conflicted by any personal interests of a majority of directors."[272]

The line may be more difficult to draw in cases of conflict of interest between different groups of shareholders. Under Delaware law, a director representing a shareholder, such as a venture capitalist, would not be considered disinterested by the courts in a transaction with that shareholder, which is why a decision on a self-dealing transaction in which this director participated would be subject to entire fairness review.[273] In cases where a clear advantage is conferred to the sponsoring shareholder, constituency directors are thus not even in the position to promote their sponsors' interests. In the case of a corporate objective that requires di-

269. JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 49 (1989).

270. ROBERT C. CLARK, CORPORATE LAW 603 (1986); *see also* Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford*,* 3 VA. L. & BUS. REV. 177, 182 (2008).

271. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 582–83 (2003); *see also* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733, 775 (2005) ("So even Dodge, the high-water mark for the supposed duty to profit-maximize, indicates that no such enforceable duty exists."); Macey, *supra* note 272, at 181, 190.

272. Baird & Henderson, *supra* note 109, at 1322.

273. Smith, *supra* note 51, at 62–63; Veasey & Di Guglielmo, *supra* note 15, at 770.

rectors to promote "the interest of the enterprise" or of a broader set of corporate constituencies, it is even clearer that it is nearly impossible for a court to enforce any specific action.[274] We can probably say for the countries surveyed, when it comes to mere disagreements about corporate business policies between different groups of shareholders, fiduciary duties are an equally impotent mechanism as in decisions.

The lack of enforcement of a strictly binding corporate objective thus leaves considerable decision making space to be filled by directors. Some of the leading economic theories of U.S. corporate law are essentially built around this fact. Both Stephen Bainbridge's "director primacy" model,[275] and Margaret Blair and Lynn Stout's "team production" model[276] could be characterized with the motto of 18th-century enlightened absolutism: "All for the people, but without the people."[277] Both models emphasize that the board stands "at the apex of the corporate hierarchy,"[278] while shareholders (or anyone else) can exert only vestigial influence, both as a matter of Delaware corporate law and the practice of the Berle-Means corporation.[279]

The models differ with respect to who is the "people" in the metaphor in each case. Bainbridge suggests that the board, as a more cohesive body than shareholders collectively, enables effective decision making and overcomes collective action problems in what is essentially a hierarchical organization.[280] Yet, the beneficiaries are exclusively shareholders.[281] By contrast, Blair and Stout interpret the board of directors as an institution balancing the interests of various constituencies and making specific investments in the relationship with the corporation.[282]

An important question would seem to be why directors should pursue either group without any legal enforcement. In that respect, both models rely to some extent on social norms, although the authors obviously differ about their content.[283] A recent article has taken a further step and argued that the controlling interests are in fact "indeterminable

274. *See, e.g.*, Mariana Pargendler, *State Ownership and Corporate Governance*, 80 FORDHAM L. REV. 2917, 2935 (2012) (noting that the broad objective of Brazilian corporate law suited the needs of the government as a controlling shareholder).

275. Bainbridge, *supra* note 273, at 550.

276. Blair & Stout, *supra* note 225, at 249–50.

277. This motto, which reads "Alles für das Volk, aber nichts durch das Volk" in German, is often ascribed as characterizing the rule of the Holy Roman Emperor Joseph II in the Habsburg domains.

278. Bainbridge, *supra* note 251, at 2.

279. Bainbridge, *supra* note 273, at 568–73; Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board,* 79 WASH. U. L. Q. 403, 423–26 (2001).

280. Bainbridge, *supra* note 273, at 557.

281. *Id.* at 550.

282. Blair & Stout, *supra* note 281, at 418–22.

283. Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH & LEE L. REV. 1423, 1441 (1993) ("[T]he shareholder wealth maximization norm is central to management's socialization . . . ."); Blair & Stout, *supra* note 281, at 438–43 (discussing the role of trust in attracting both capital and skilled labor); *see also* Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 DEL. J. CORP. L. 649, 714–17 (2004) (comparing and critiquing both models).

within current models because of directors' absolute rulemaking power."[284]

Social norms and corporate culture are clearly important in a Berle-Means system with dispersed ownership and disempowered shareholders. Even in this system, directors are subject to economic constraints that incentivize them to pursue certain objectives, such as the threat of hostile takeovers and executive compensation plans intended to align their interests with those of shareholders. It is most likely no accident that directors became more mindful of shareholder interests in the 1980s and 1990s, when the threat of hostile takeovers was present and executive compensation grew respectively.[285] Moreover, in recent years there has been an understanding that the growth of institutional share ownership at the expense of retail investors has increased the direct influence of shareholders over the board, which has ceased to be an absolute monarch.[286]

The types of constituency directors discussed here are a way of shortcutting past all of these mechanisms. Each type of "constituency director" is subject to a specific set of social norms, economic incentives, and psychological factors that influence decision making. Directors representing large shareholders, for example, "fulfill the latter's explicit requests and implicit expectations."[287] The outcome of board deliberations is obviously determined by how directors are nominated and appointed. Since corporate law does not provide a clear and enforceable objective, one can thus conclude that the "interest of the corporation" is not to be understood substantively, but procedurally. The interest of the corporation, however defined, thus becomes primarily the outcome of board deliberations; the purpose of permitting a specific type of director on the board is to integrate the interests of her constituency into the determination of corporate policies. As it is often suggested in the specific context of German supervisory boards with capital and labor benches,[288] such an

284. René Reich-Graefe, *Deconstructing Corporate Governance: Absolute Director Primacy*, 5 BROOK. J. CORP. FIN. & COM. L. 341, 396 (2011).

285. Gelter, *supra* note 231, at 180–81 (discussing the possible impact of these developments on the firm-employee relationship); Gelter, *supra* note 92, at 919–21 (discussing how the Blair & Stout model seems to provide a good fit for the managerialism of the 1950s through 1970s, but not of the contemporary American firm); *see also* Gordon, *supra* note 76, at 1514 n.187 (viewing the Blair & Stout model as an explanation of the 1950s firm).

286. Anne Tucker, *The Citizen Shareholder: Modernizing the Agency Paradigm to Reflect How and Why a Majority of Americans Invest in the Market*, 35 SEATTLE U. L. REV. 1299, 1309–21 (2012); Gilson & Gordon, *supra* note 101, at 874–88; Edelman et al., *supra* note 98 (all discussing the trend from retail investment to share ownership through intermediaries).

287. Licht, *supra* note 65, at 610.

288. As is pointed out in a leading treatise, "[codetermination] primarily aims at employee representatives introducing the concerns of employees into board deliberations, and permitting both the supervisory and management board to open up themselves to these concerns within the boundaries of their entrepreneurial discretion, in other words a *procedural understanding* of the interest of the enterprise." HABERSACK, *supra* note 40, Vor § 95 para. 13 (own translation). Friedrich Kübler further summarizes this approach by saying that "[the interest of the enterprise as a legal norm] can only require that corporate management adequately respects different needs and interests; it cannot censor or correct the substance of business decisions . . . . " Kübler, *supra* note 121, at 440.

understanding of the interest of the corporation fits the broad array of situations of "constituency" or "nominee" directors of all stripes. In all likelihood, a differently composed board of directors will develop a substantively different "interest of the enterprise" in the individual case depending on what constituencies are represented. In the absence of a determinate, enforceable goal, one may just as well understand the objective as the "big picture" policy set by the board itself. Obviously, this objective will change over time, given changes in the economic and social environment of the corporation that affect the cultural and economic factors that influence directors.

B. Heterogenous Loyalties and the Confidentiality of Sensitive Information

Directors are typically subject to a duty of confidentiality that prohibits them from sharing nonpublic information from the company with their sponsor.[289] Access to information, however, may be precisely the reason why a venture capital investor wants to be represented. It would enable her to step in early if the corporation embarks on business policies she does not agree with or, worse, if the corporation is on a trajectory toward severe problems. The firm might benefit from earlier action by a venture capitalist, but in some cases it might exacerbate conflicts of interests with other shareholders.

The unitary vision on different types of directors we have developed in this Article may help to shed light on this issue. Information sharing has long been a major issue in the debate about German codetermination. Scholars have often argued that the presence of employee representatives on the supervisory board discourages the company's management, specifically the CEO, from sharing information with the supervisory board.[290] Even though it is problematic under the law, the CEO—together with the chair of the supervisory board, who frequently plays a prominent role—may decide that certain information (e.g., about proposed downsizing) should be kept from the supervisory board as long as possible because they will likely leak the information to the union, politicians, or the business press. It has thus been argued that the absence of a continued flow of information undermines the functioning of the German supervisory board. Others have argued that employee participation may eliminate some information asymmetries between executives and other employees, and thus reduce the costs of collective bargaining

289. For the United States, see Cyril Moscow, *Director Confidentiality*, 74 L. & CONT. PROBS. 197, 197 (2011); Sepe, *supra* note 37, at 340–41; for Germany, see §§ 93(1), 116 AktG (Ger.).

290. *See, e.g.*, Jean J. Du Plessis & Otto Sandrock, *The Rise and Fall of Supervisory Board Codetermination in Germany?*, 16 INT'L COMPANY & COM. L. REV. 67, 74–75 (2005); FitzRoy & Kraft, *supra* note 247, at 236 (citing studies suggesting that information is sometimes deliberately withheld); Mark J. Roe, *German Codetermination and German Securities Markets*, 1998 COLUM. BUS. L. REV. 167, 171–75; *see also* Weber-Rey & Buckel, *supra* note 60, at 17 (suggesting that a relaxation of the duty of confidentiality for government representatives on the board may make trusting cooperation more difficult within this body).

and the incidence of strikes.[291] Better-informed employees may be less likely to object to necessary restructuring.[292] Moreover, some (highly trained) employees may also constitute a valuable source of information for the board.[293]

Information sharing between directors and their sponsors is thus a double-edged sword. There are risks, but, in some cases, companies may benefit because information often flows in two directions. Even if information only flows to the individual or interest group standing behind a director, the company—and everyone with an interest in it—may benefit because that individual is put into the position to take beneficial initiatives. As Ringe has recently suggested, constituency directors may even help to overcome problems caused by the strong reliance on independent directors on modern boards, such as lack of knowledge about the firm and the industry in which it operates, as well as insufficient incentives to develop a strong interest in it: "Dependent" directors may in fact strengthen the information flow to their sponsors, who will typically have a strong interest in the firm and will want action to be taken if things go wrong.[294]

Two well-known cognitive biases are likely to reinforce, in reality, behaviors on behalf of directors that relate to constituency-influenced sensitive information sharing. Morck offers some other psychological tendencies that might reinforce the deference to insider authority.[295] In particular, inclination toward *reciprocity* might cause board members to defer—consciously or not—out of gratitude for the invitation to join the board and the perquisites of membership.[296]

In addition, *in-group/out-group biases* might cause board members to reject externally generated threats directed at others on the board "team," especially if the board has developed a fairly close working relationship.[297]

For all these reasons, structurally, it is tempting to suggest that a "uniform standards strategy" conforms rather to a large, publicly traded firm with a dispersed ownership structure and a relatively independent board that is insulated from the pressures of specific interest groups. A "diverse constituency strategy," especially as we look at shareholders, may rather correspond to a corporation possibly with multiple large investors. It may thus be advisable to permit information sharing with the constituency directors' sponsors, at least by permitting firms to opt out of confidentiality. This is probably more problematic where the constituency is on the board not because of private ordering, but because of manda-

291. Gérard Hertig, *Codetermination as a (Partial) Substitute for Mandatory Disclosure?*, 7 EUR. BUS. ORG. L. REV. 123, 127 (2006).

292. *Id.* at 130.

293. Margit Osterloh & Bruno S. Frey, *Shareholders Should Welcome Knowledge Workers as Directors,* 10 J. MGMT. & GOVERNANCE 325, 330 (2006); Hertig, *supra* note 293, at 128.

294. Ringe, *supra* note 80, at 422.

295. Morck, *supra* note 266, at 180.

296. *Id.* at 196.

297. *Id.* at 192.

tory law, such as in the case of employee representatives in countries such as Germany and France.[298] Confidentiality could be limited to such cases, or the misuse of information for purposes that clearly harm the corporation could be more strongly sanctioned.

VI. CONCLUSION

> Who can be wise, amazed, temperate, and furious, / Loyal and neutral, in a moment? No man.[299]
> (Macbeth, II, 3, 155)

As we have seen, the prevailing conception of fiduciary duties stands in tension with what is the possibly desirable constituency interest representation on the board from a theoretical standpoint. Arguments in favor of uniform duties seem to rest primarily on a conception of a board as a deliberative body, much like a political body, a court, or a jury. Both economic incentives and behavioral theory suggest that with the presence of directors representing a specific group, board deliberation is likely to turn into negotiations between the different interests rather than deliberation. Since representative directors are put on the board to address an incomplete contracts problem, the case in favor of uniform duties is rather weak. Moreover, the appointment of constituency directors seems to be in line with a trend toward more explicit representation of various stakeholders across jurisdictions, which is partly linked to larger trends in corporate governance. In practice, restrictions imposed by corporate law on the books may not matter all that much. In other words, fairness may not suffer from the preference given to the standard duty strategy. Why is that? Beyond the legal logic, what is at stake is the reality of business life. Corporate law deals with a dual reality: Corporate law is pragmatic and leaves large gaps in the constraints on directors' duties and their enforcement, thus enabling the corporation to develop and evolve.

As we have seen, given how corporate boards are set up to operate, the homogeneity of fiduciary duties looks like a chimera: Across jurisdictions, directors have large freedoms to decide about corporate policies, and are thus positioned to pursue the interests of their respective nominators or constituency. Within this discretion accorded to directors by corporate law, these are positioned to ultimately determine themselves what the objective of the corporation is. In doing so, they are subject to pressures from various economic and social forces that, at times, push them into one director or the other, thus enabling them to steer the firm

298. Though corporate legal culture has developed arrangements to limit the impact of such disclosures, see JEAN-EMMANUEL RAY, DROIT DU TRAVAIL, DROIT VIVANT (2013) (stating that, in practice, employee representatives may not necessarily immediately inform the community of employees of every development, e.g., regarding mergers).

299. WILLIAM SHAKESPEARE, MACBETH, act 2, sc. 3.

through the current circumstances. What may appear to be a flaw at first sight turns out to be an enabling component in corporate law. More than any other area in the law, the life of corporate law "has not been logic: it has been experience."[300] Given directors' discretion, it matters even more how directors are elected or appointed; directors representing particular interests are subject to different social and economic pressures that are reinforced by psychological tendencies. Therefore, they are likely to steer the corporation on a different course than in a corporation with a more traditional board dominated by senior management. Analysts of corporate law are therefore well advised to pay close attention to the way the corporation itself is organized and works. Practice is here a subtle source of *de facto* norms. In particular, the function of a heterogeneous group of directors may therefore be to create a process of board decision making that will define the specific corporation's objective depending on which groups are represented on the board and that may, at times, look more like negotiation between different groups than deliberation for a common purpose.

300. OLIVER WENDELL HOLMES, JR., THE COMMON LAW 1 (American Bar Association 2009) (1881).