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ARTICLE: THE CHALLENGE OF COMPANY STOCK TRANSACTIONS FOR DIRECTORS' DUTIES OF LOYALTY

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SUMMARY:
... Part 1 describes the duty of loyalty in trust law, upon which loyalty obligations in state corporate law and federal ERISA law are based. ... We conclude that both Delaware corporate law and federal law, under ERISA, must continue to give serious and flexible content to the fiduciary duty of loyalty. ... Another question left unanswered by the *ECM* court is whether lack of independence by itself is enough of a conflict of interest to implicate the duty of loyalty. ... This Part analyzes and compares recent developments in the fiduciary duty of loyalty in Delaware corporate law and in federal law under ERISA. ... In the very next sentence, the court held that Raynor had violated his duty of "loyalty and/or good faith," and attributed its inconclusiveness to its concern that Delaware law might require "a self-dealing conflict of interest in the interest in the transaction." ... Federal district courts are only beginning to evaluate fiduciary actions for duty of loyalty violations in the ERISA employer stock cases, whereas Delaware courts have long subjected corporate fiduciaries to scrutiny for lapses of loyalty in company stock transactions in the general corporate context. ...

HIGHLIGHT: *This Article explores the intersection of state and federal law in defining corporate directors' duties of loyalty to shareholders and obligations to 401(k) plan beneficiaries. Part 1 describes the duty of loyalty in trust law, upon which loyalty obligations in state corporate law and federal ERISA law are based. Part II explores the evolving role of the duty of loyalty in Delaware corporate law. Part III analyzes the loyalty obligations that the ERISA law imposes and examines the application of loyalty principles in 401(k) employer stock litigation. Part IV scrutinizes how Delaware jurisprudence and ERISA law diverge and argues that enhanced scrutiny should apply to transactions in which fiduciaries suffer from a "substantial lack of independence." The authors argue that limiting enhanced scrutiny to situations of self-dealing in the transaction itself fails to properly protect shareholders and conclude that their proposal offers increased flexibility and effectiveness in protecting beneficiaries and shareholders from self-interested fiduciaries.*

TEXT:

[*437] Seventy-seven years have passed since Justice Cardozo, while serving as Chief Judge of the New York Court of Appeals, opined that joint adventurers owe one another "the duty of the finest loyalty." n1 He described this standard with the famous phrase: "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." n2

One might logically expect the elapsed years and the wealth of state corporate law litigation to have defined any remaining contours in corporate directors' duties of loyalty. Such logic, however, is not justified in this instance. In a recent opinion, which has become well known for other reasons, n3 the Delaware Chancery Court recognized that "the Delaware Supreme [*438] Court has yet to articulate the precise differentiation between the duties of loyalty and of good faith." n4 This contributed to a debate about the role of good faith in Delaware corporate law. In *In re Walt Disney Company Derivative Litigation (Disney II),* however, the chancery court stated that "[i]t does no service to our law's clarity to continue to separate the duty of loyalty from its essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement." n5

One of the areas where corporate directors' duties of loyalty are most important, as well as most complex, is in the context of transactions in company stock. Those transactions might involve a going private transaction, n6 which have become more frequent in the more intense regulatory environment of the post-Sarbanes-Oxley Act n7 period; a freeze-out merger; n8 or use of employer stock in 401(k) plans.

At the same time that Delaware law on directors' fiduciary duty of loyalty has come under scrutiny, directors increasingly face fiduciary litigation under the Employee Retirement Income Security Act of 1974 (ERISA). n9 In one category of such cases, the "ERISA employer stock" cases, the plaintiffs typically allege that directors breached their fiduciary duty of loyalty vis-a-vis the employees' investment in company stock where the investment was made through employer-sponsored benefit plans. n10 The scope of directors' fiduciary obligations in those cases has become the subject of considerable litigation. n11

In this Article we consider the developing standards of loyalty governing director conduct and the tension between state and federal laws. Part I describes the fiduciary duty of loyalty in trust law, upon which loyalty obligations in state corporate law and fiduciary standards in 401(k) regulations are based. Part II explains how the business judgment rule and exculpatory provisions often protect corporate directors from liability, thereby establishing the duty of loyalty as a critical principle in protecting the capital structure of corporations. The Part then evaluates the duty of loyalty imposed on directors by Delaware corporate law with special emphasis on the chancery court's opinions in *Disney II* and *In re Emerging Communications, Inc. Shareholders Litigation (ECM).* n12 It concludes that the *Disney II* court appropriately utilized a rigorous loyalty analysis. In comparison, [*439] the *ECM* court signaled an analysis that may set an inappropriately arbitrary standard.

Part III analyzes the fiduciary loyalty obligations imposed by ERISA. Although ERISA's fiduciary scheme draws upon trust law, it is complicated by provisions permitting conflicted fiduciaries and limiting fiduciary obligations to decisions made as a fiduciary as opposed to decisions made in a nonfiduciary role. Part III then examines the application of loyalty principles in the specific context of the 401(k) employer stock litigation. Breach of loyalty allegations surface in the context of claims that plan fiduciaries failed to terminate the use of company stock in the plan or permit the plan participants to diversify their investments, failed to properly appoint or monitor other plan fiduciaries, or failed to fully and honestly disclose important facts. n13

Part IV scrutinizes the significant ways in which the duty of loyalty jurisprudence in Delaware corporate law diverges from the federal law of ERISA. Part IV argues that corporate law transactions should receive enhanced scrutiny when the relevant fiduciaries operate under a substantial lack of independence. Additional limitations on fiduciary review, such as the *ECM* court's indication that only self-dealing in the transaction itself can give rise to a breach of loyalty, would fail to protect shareholders from self-interested fiduciaries. The ERISA fiduciary standards are less well-developed than the corporate law standards and must accommodate some level of self-interest because of the statutory provision for conflicted fiduciaries. However, permitting corporate officers and other individuals with ties to the plan sponsor to serve as fiduciaries should not nullify ERISA's imposition of the duty of loyalty. As is true in corporate law settings, a substantial lack of independence by plan fiduciaries poses a serious risk of self-interested decisionmaking. We conclude that both Delaware corporate law and federal law, under ERISA, n14 must continue to give serious and flexible content to the fiduciary duty of loyalty.

I. TRUST LAW AS THE SOURCE OF THE FIDUCIARY DUTY OF LOYALTY

Both state corporate law and federal employee benefit plan law have relied on trust law in shaping their development of fiduciary obligations. Trust law provides that a trustee must act "solely in the interest of the [trust]." n15 In situations where there are multiple current beneficiaries, the [*440] trustee must be impartial among those beneficiaries. n16 Similar obligations arise when the trust provides for successive beneficiaries. n17

Historically, trustees have been subject to harsh conflict of interest standards. When a fiduciary acts in a transaction in which her personal interest conflicts with the beneficiary's interest, the basic rule is to conclusively presume the transaction to be invalid. n18 This presumption is intended to reflect the assumption that a trustee acting under the temptations inherent in a conflict of interest will all too often neglect the best interests of the beneficiary. n19

Given both the draconian nature of trust law's conclusive presumption and the changing nature of trusts and trustees, it is not surprising that exceptions permit specific categories of interested transactions. n20 Professor John Langbein recently questioned this approach, suggesting instead that the presumption of invalidity should remain but that it should be rebuttable. n21 He would permit a trustee to defend a breach of loyalty allegation by proving that the transaction was in the beneficiary's best interest. n22

II. CORPORATE LAW FIDUCIARY STANDARDS

The concept of fiduciary duty, as applied to corporate officers and directors, is a significant part of corporate law jurisprudence. n23 The most salient duties are the duties of care and loyalty, n24 which are sometimes distinguished [*441] from the obligation to act in good faith. n25 This Part examines these duties in light of the decisions in *ECM* and *Disney II.*

A. The Duty of Care

Although the duty of care imposes upon directors an affirmative duty to use reasonable care under the circumstances in making corporate decisions, historically, relatively few cases have held directors personally liable for breach of due care. n26 Prior to 1987, the most likely reason for the paucity of cases was the courts' regular application of the business judgment rule. Under the business judgment rule, courts will presume that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." n27 Where the presumptions of the business judgment rule apply, courts have been loath to second guess business decisions. In order to qualify for business judgment rule protections, the directors must have acted in good faith and in the best interest of the corporation without breaching the duty of loyalty. n28

In 1986, Delaware adopted Section 102(b)(7) of the Delaware Code to provide that corporations may limit or eliminate the potential liability of corporate directors for breach of the duty of care by including an exculpatory provision in the company's articles of incorporation. n29 Nearly [*442] all states have followed suit and have adopted similar legislation. n30 Thus, post-1986, not only are directors protected from liability through the business judgment rule jurisprudence, but they are also protected by the 102(b) (7)-type exculpation provided in the articles of incorporation of the firms they serve.

The Delaware Chancery Court discussed the duty of care in its recent decisions regarding the activities of the board of directors of The Walt Disney Company. In May 2003, the Delaware Chancery Court, *In re Walt Disney Co.,* denied a motion to dismiss the claims against the directors of The Walt Disney Company alleging lack of good faith and breach of due care regarding the board's approval of an employment agreement. n31 An earlier complaint was dismissed in *Brehm v. Eisner,* n32 because the complaint did not allege sufficient facts to overcome the presumption of the business judgment rule. The later complaint alleged that the "defendant directors consciously and intentionally disregarded their responsibilities." n33 The court let the claim stand for a determination whether the board "exercised any business judgment or made any good faith attempt to fulfill the fiduciary duties they owed to Disney and its shareholders." n34

[*443] After a trial on the merits, the Delaware Chancery Court in *Disney II* n35 found that the directors were not liable for breach of any fiduciary duty. The court stated that duty of care requires the directors to "use the amount of care which ordinarily careful and prudent men would use in similar circumstances" n36 and to "consider all material information reasonably available." n37 The court noted that liability may arise either from a negligent board decision or failure to pay due attention. n38 Despite that seemingly broad base for liability, *Disney II* emphasized that the threshold to prove a breach of care is very high due to the business judgment rule. n39 According to the court, as long as a director has acted in good faith, the director "should be deemed to satisfy fully the duty of attention." n40 In order to recover for a violation of this duty, a plaintiff must show a lack of good faith as evidenced by systematic failure to exercise reasonable oversight. n41 Although the court recognized that the actions of the director defendants "fell significantly short of the best practices of ideal corporate governance," n42 the court concluded that Delaware law does not hold them liable for failure to comply with the "aspirational ideal of best practices." n43

Thus, between the protections afforded by the business judgment rule and the exculpatory legislation adopted by most states, the duty of care analysis appears to turn on the exceptions to the business judgment rule, violations of loyalty or good faith. Neither business judgment rule protection nor exculpation is available for acts in violation of the duty of loyalty or lacking in good faith. Because liability does not attach for negligent or grossly negligent violations of due care, claims regarding breach of loyalty or lack of good faith take on added significance. These issues were at the forefront of the plaintiffs' claims in *Disney II* n44 and *In re Emerging Communications, Inc. Shareholders Litigation.* n45

[*444] *B. The Duty of Loyalty*

As discussed above, the fiduciary duties in corporate law, including the duty of loyalty, have their genesis in the law of trusts. n46 This relationship exists between trustees and their beneficiaries and between agents and their principals. n47 A fiduciary relationship exists "when one is given power that carries a duty to use that power to benefit another." n48 Although corporate officers and directors as fiduciaries are not formally considered trustees of the organizations they serve, n49 corporate law analogizes to the fiduciary obligations of trustees when determining the scope of corporate fiduciary duties. n50

The duty of loyalty requires corporate officers and directors to refrain from using their corporate position of trust and confidence for their own benefit. n51 It has thus become well-established in corporate law that a conflict of interest will trigger a duty of loyalty analysis. n52 Loyalty "requires [*445] [that] officers and directors not profit at the expense of their corporation ...." n53 In *Guth v. Loft, Inc.,* n54 the Delaware Supreme Court analogized to the law of trusts in finding the president and director liable for breach of the duty of loyalty for taking personal advantage of an opportunity that came to him because of his position in the corporation. n55 The court said that a director is obligated to "affirmatively ... protect the interests of the corporation committed to his charge." n56 More recently, the Delaware Chancery Court in *Disney II* n57 reaffirmed this obligation. Quoting *Guth, Disney II* stated that "[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests ... The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest." n58 *Disney II* then found that there is no safe harbor for divided loyalties, citing the classic example of a transaction where a fiduciary appears on both sides and derives a benefit not shared by other shareholders. n59

Yet, although the duty of loyalty requires the "punctilio of an honor the most sensitive," n60 conflicts of interest do not automatically give rise to breach. However, when a transaction gives rise to a conflict of interest between members of the board and the corporation, the presumptions of the business judgment rule or of § 102(b)(7)-type exculpatory provisions no longer apply to protect the business decisions of the board members. n61 If the conflict in a transaction is disclosed and disinterested members of the board approve the transaction, there will generally be no cause for liability. n62 If a transaction is contested because the decision was not made by a disinterested board, a court will likely evaluate the transaction substantively for fairness. n63

[*446] Fairness issues come to the fore in the context of claims made by minority shareholders regarding the unfairness of a freeze-out merger. In these cases, the courts shift the burden of proof of fairness to the defendants who approved the transaction. For example, the fairness standard was applied by the court in *Cinerama, Inc. v. Technicolor, Inc.,* n64 where the plaintiff alleged that the defendant directors violated their duty of loyalty in approving a merger. The court held that the burden of proof shifted to the directors to prove the entire fairness of the transaction because the business judgment rule had been rebutted. The court stated that in assessing the entire fairness of a transaction, "the court must consider the process itself that the board followed, the quality of the result it achieved and the quality of the disclosures made to the shareholders to allow them to exercise such choice as the circumstances could provide." n65 The court affirmed the decision of the lower court, holding that its use of a disciplined balancing test in determining fairness and credibility would not be disturbed. n66

Similarly, in *Roland International Corp. v. Najjar,* n67 the court held that "even when a parent corporation has a *bona fide* purpose for merging with its subsidiary, the minority shareholders of the subsidiary are entitled to judicial review for 'entire fairness' as to all aspects of the transaction." The Delaware courts thus recognize the special conflicts that may arise in transactions between majority and minority shareholders. n68

[*447] *1. Duty of Loyalty and/or Good Faith:* In re Emerging Communications, Inc. Shareholders Litigation

In *In re Emerging Communications, Inc. Shareholders Litigation ("ECM"),* n69 the Delaware Chancery Court recently considered allegations of breach of the duties of care, loyalty, and good faith in connection with a board's decision to sell a company in a going-private transaction. The *ECM* plaintiffs were former minority shareholders of Emerging Communications, Inc. (ECM) who sold their stock to Innovative Communications Corporation (Innovative) in a two-step transaction designed to take ECM private. n70 Innovative was owned by Innovative Communication Company (ICC), which was also a majority shareholder of ECM. ICC in turn was owned by ECM's Chairman and Chief Executive Officer, Jeffrey Prosser, who thus had voting control over both ECM and Innovative. The plaintiffs filed actions requesting a statutory appraisal of the value of the shares sold and claiming in a class action that the transaction was not entirely fair to the ECM minority shareholders and thus was in breach of the directors' fiduciary duties. n71 The court consolidated the claims. n72

In considering the claim of breach of fiduciary duty, the court cited the Delaware Supreme Court decision in *Emerald Partners v. Berlin* n73 and determined that analysis of a "going private" transaction and the liability of the fiduciaries requires application of the entire fairness standard. n74 This standard considers both fair dealing and fair price. n75

The court first made a determination of the fairness of the price paid for the shares. n76 After a lengthy financial analysis, the court rejected the defendants' claim that the price was fair, holding that the $ 10.25 price paid to the minority shareholders represented neither the fair value nor the intrinsic value at the time of the merger. n77 Instead, the court determined that the fair value at the time of the transaction was $ 38.05 per share. n78

Once the court determined that the price was unfair, the question became whether a fair dealing analysis was necessary. n79 The chancery court noted that Delaware law had not yet determined whether an unfair price establishes "*ipso facto,* the unfairness of the merger, thereby obviating the need for any analysis of the process oriented issues." n80 The court found, [*448] however, that a fair dealing analysis was required because a Section 102(b) (7) exculpatory defense had been raised by defendants, n81 "if only to enable the Court to determine the 'basis for the [defendants'] liability' for § 102(b)(7) exculpation purposes." n82 The determination of an unfair price did not "address whether the unfairness was the product of a breach of fiduciary duty or if so, the nature or character of that duty." n83

The court then proceeded with a fair dealing analysis. The court reviewed "when the transaction was timed, how it was initiated, structured, negotiated, and disclosed to the board, and how director and shareholder approval was obtained." n84 An analysis of these factors led the court to conclude that the privatization transaction failed the entire fairness standard. n85 The court found that Prosser's original intent, in about January 1998, was not to privatize the company but instead to merge Innovative into a subsidiary of ECM. n86 But by May 1998, in light of the low market interest in ECM's common stock, Prosser decided to "flip the transaction," n87 and become a buyer instead of a seller. Based on these facts the court found that this transaction, which was initiated by a majority stockholder to freeze out the minority shareholders at a time when the stock price was artificially low, was unfair in both its initiation and timing. n88

When Prosser was contemplating the original merger transaction, he engaged the Prudential firm to evaluate the fairness of the merger for ECM and the Cahill, Gordon and Reindel (Cahill) law firm to assist ECM with drafting the terms of the merger. n89 When Prosser later decided to privatize, he hired both Prudential and Cahill to advise him personally with regard to the privatization transaction. n90 By co-opting Prudential and Cahill, Prosser thus deprived ECM's board of valuable advisors. n91 The court found these facts indicative of unfairness in the structure of the transaction. n92

The court next addressed the question of whether a transaction adjudicated to be not entirely fair violates the duty of care, the duty of loyalty, or the duty of good faith. If the violation were solely one of due care, ECM's 102(b)(7)-type provision would exonerate the directors from money damages. But this exoneration would not be applicable "(i) for any breach of the director's duty of loyalty, (ii) for acts or omissions not in good faith or [*449] which involve intentional misconduct or a knowing violation of the law . . . ." n93

The *ECM* court went on to determine the nature of the fiduciary duties for each director individually. Prosser, the chairman, CEO and controlling stockholder, was found to have breached his duty of loyalty "by eliminating ECM's minority stockholders for an unfair price in an unfair transaction." n94 His receipt of an improper personal benefit from the transaction also nullified the exculpation provision. n95

Director Raynor was also found to have breached his duty. Although Raynor did not personally profit from the transaction as Prosser did, he furthered Prosser's interests as opposed to the interests of the minority shareholders. Raynor served both as Prosser's personal attorney and ECM's counsel, n96 and he acted as Prosser's advisor in connection with the transaction. n97 The court stated that although Raynor did not directly benefit, his loyalties were solely to Prosser because his economic interests were tied solely to Prosser. n98

Interestingly, although the court at one point stated that "Raynor ... is liable for breaching his fiduciary duty of loyalty," n99 it later found that Raynor breached "his fiduciary duty of loyalty and/or good faith." n100 According to the court:

> Raynor did not personally and directly benefit from the unfair transaction (as did Prosser), but Raynor actively assisted Prosser in carrying out the Privatization, and he acted to further Prosser's interests in that transaction, which were antithetical to the interests of ECM's minority stockholders ...
>
> Accordingly, Raynor is liable to [plaintiffs] for breaching his fiduciary duty of loyalty and/or good faith. n101

The court explained this unusual finding by noting that the Delaware Supreme Court "has yet to articulate the precise differentiation between the duties of loyalty and good faith." n102 It further stated that:

> [*450] If a loyalty breach requires that the fiduciary have a self-dealing conflict of interest in the transaction itself . . . Raynor would be liable [only] for violating his duty of good faith for consciously disregarding his duty to the minority stockholders ... On the other hand, if a loyalty breach does not require a self-dealing conflict of interest or receipt of an improper benefit, then Raynor would be liable for breaching his duties of loyalty and good faith. n103

The court did not decide the issue, because either way, Raynor's conduct would violate the duty of good faith and would not be exculpated. n104

From this finding, it would be logical to infer that good faith is a fiduciary duty separate from the duties of loyalty and care and that conscious disregard for these latter duties violates the duty of good faith. However, this issue is apparently not settled in Delaware. As discussed in Part II.C below, the *Disney II* court stated "there is no case in which a director can act in subjective bad faith towards the corporation and act loyally." n105 Thus, once a determination was made that Raynor did not act in good faith, application of the analysis of *Disney II* would seemingly require a finding that he had also violated his duty of loyalty. Even so, neither *ECM* nor *Disney II* answers the question regarding whether, absent evidence of bad faith, a finding of self-dealing in the transaction itself is required to establish a loyalty breach.

Having addressed Raynor's liability, the court turned to the liability of director Muoio. Muoio was also held liable for breach of the duty of loyalty and/or good faith, n106 although the court found his conduct less egregious than that of Prosser and Raynor. n107 Muoio was held liable "because he voted to approve the transaction even though he knew, or at the very least had strong reasons to believe, that the $ 10.25 per share merger price was unfair." n108 Muoio had significant experience in finance and telecommunications in light of his position with an investment advising firm. n109 The court held that Muoio should have advised the board to reject the $ 10.25 price. n110 Rather than delineate between the duties of loyalty and good faith, the court held that Muoio's conduct violated the duty of "loyalty and/or good faith." n111 It thus appears that the "conscious disregard" standard that [*451] the court is applying in the context of good faith is breached if the director "knew or had strong reasons to believe" that a transaction was unfair.

It is also noteworthy that Muoio was found not to be independent of Prosser when the court undertook the fair dealing analysis. n112 Although the court noted that Muoio's independence was in question because he would likely wish to seek future business opportunities from Prosser, it appears that the court was uncertain whether this lack of independence was enough of a conflict of interest to raise concerns about the duty of loyalty. Instead of making the determination regarding whether a conflict in the transaction is a necessary finding in a loyalty case, the court sidestepped the issue and found Muoio in violation of loyalty and/or good faith, due to his lack of independence from Prosser. n113

The four remaining directors, Goodwin, Ramphal, Todman, and Vondras, were not found liable for breaching either the duty of loyalty or good faith. With respect to these four, the court found that the evidence did not implicate more than breach of the duty of care. n114 None of these directors had received an improper personal benefit, nor did any of them have a personal conflicting financial interest in the transaction. n115 Of these four directors, only Goodwin was found to be possibly independent of Prosser. n116 Yet, it seems that lack of independence could not sustain liability for Ramphal, Todman, and Vondras because their votes were not found to have been motivated by lack of independence. The court stated:

> [T]here is no evidence that they actually engaged in such improperly motivated conduct, or otherwise acted with disloyal intent ... But negligent or even gross negligent conduct, however misguided, does not automatically equate to disloyalty or bad faith. There is no evidence that Goodwin, Ramphal and Vondras intentionally conspired with Prosser to engage in ... benefiting Prosser at the expense of the minority stockholders. n117

The *ECM* court did not decide whether the duty of loyalty or the obligation of good faith was breached in the cases of Muoio and Raynor. Rather, the court in effect stated that good faith was breached and loyalty may have been. *Disney II* seems to provide an answer to this aspect of the loyalty question because, according to *Disney II*, lack of good faith is tantamount to breach of the duty of loyalty. n118 The next sections revisit the [*452] duty of loyalty and the obligation of good faith, with an objective of picking up the analysis from where *ECM* left off.

2. Conflict of Interest in the Transaction

The case law is relatively clear that a director's conflict of interest in a corporate transaction will trigger an analysis of whether there is a breach of the duty of loyalty. n119 What is murky, in light of the decision in *ECM,* is whether lack of independence is enough of a conflict of interest to implicate the duty of loyalty, or whether a more direct conflict of interest in the transaction itself is required. This Section returns to the origins of the duty of loyalty to analyze whether evidence of a conflict of interest in the transaction is necessary to establish breach.

As discussed above, corporate law fiduciary duties have their genesis in the law of trusts. n120 According to the Restatement (Second) of Trusts, the trustee's duty of loyalty is a "duty to the beneficiary to administer the trust solely in the interest of the beneficiaries." n121 This definition does not seem to require self-dealing before finding a violation. However, if the transaction presents conflicts of interest, the trustee is "under a duty to deal fairly and to communicate to the beneficiary all material facts the trustee knows or should know in connection with the transaction." n122

As mentioned above, one of the more famous cases discussing the contours of the duty of loyalty in the context of a business relationship is *Meinhard v. Salmon.* n123 The *Meinhard* case involved application of the duty to a joint venture relationship. Chief Justice Cardozo, addressing the duty of joint adventurers to each other, said that they owe one another "the duty of the finest loyalty . . . the punctilio of an honor the most sensitive." n124 Although evidence of conflict of interest in the transaction could lead to a finding of breach of the duty of loyalty, it did not seem to be a requirement of breach. That is, a conflict of interest could evidence a breach of loyalty, as could any other behavior indicating that the director did not communicate all material facts or did not otherwise act with "an honor the most sensitive."

3. Lack of Independence

Another question left unanswered by the *ECM* court is whether lack of independence by itself is enough of a conflict of interest to implicate the duty of loyalty. In finding Raynor and Muoio liable for breach of loyalty [*453] and/or care, the court stated that loyalty was only implicated if a conflict of interest in the transaction itself was not required. n125 Raynor and Muoio were not found to be interested in the transaction. They were, however, beholden to Prosser and not independent advisors to the company.

Although lack of independence is not an issue that has been decided by the Delaware Supreme Court in the context of breach of loyalty claim, it is an issue that has been addressed recently by the Chancery Court. In *Orman v. Cullman,* n126 the Delaware Chancery Court stated that to establish a breach of the directors' duty of loyalty and to overcome the presumption of the business judgment rule, the plaintiff can "establish that the *board* was either interested in the outcome of the transaction or lacked the independence to consider objectively whether the transaction was in the best interest of its company and all of its shareholders." n127 The court further delineated the distinction between interest in the transaction and lack of independence. According to *Orman,* directors are interested in the transaction when they appear on both sides of a transaction or expect to derive a personal financial benefit from it in the sense of self-dealing. n128 This is in contrast to "a benefit which devolves upon the corporation or all stockholders generally." n129 On the other hand, "lack of independence can be shown when a plaintiff pleads facts that establish 'that the directors are 'beholden' to [the controlling person] or so under their influence that their discretion would be sterilized.'" n130

The *Orman* court then discussed whether the plaintiffs' allegations of breach of fiduciary duty were sufficient to survive the motion to dismiss. Four defendant directors were alleged to be interested in the transaction "because they received benefits from the transaction that were not shared with the rest of the shareholders." n131 The court found the allegations insufficient with respect to three of the directors: Israel, Vincent and Lufkin. n132 The only allegation against Israel and Vincent was that they were self-interested because they had served on the board since 1989 and 1992, respectively. n133 With respect to Lufkin, the court found that his board membership since 1976 was insufficient to show lack of independence and his role as founder of one of the two leading underwriters of the company's IPO did not establish that he received a personal benefit from the transaction not shared by other shareholders. n134 Similarly, director Barnet was [*454] not interested in the transaction solely because he was to be a director in the surviving corporation. n135

On the other hand, the court found that director Bernbach may have lacked independence because he was beholden to the Cullman Group--the group that negotiated the transaction--due to his consulting contract with that company and was beholden to the controlling shareholders for a continuation of the contract. n136 Interestingly, the court stated that the consulting contract was not enough to establish that Bernbach was interested or that he would have profited from the transaction. n137 Bernbach's potential liability was based solely on his alleged lack of independence. n138

A fifth director, Solomon, was possibly interested in the transaction because his company, PJSC, was to receive a $ 3.3 million fee if the merger were approved. n139 Finally, the court found it unnecessary to rule upon the interest or lack of independence of director Sherren because a majority of the board being interested or lacking independence was sufficient to rebut defendants' claim that the decision was protected by the business judgment rule. n140

Similarly, a U.S. district court, applying Delaware law in *Hollinger International, Inc. v. Hollinger Inc.,* n141 utilized a two-prong test in its discussion of the duty of loyalty. According to the *Hollinger* court, a breach of loyalty claim requires the plaintiff to allege that: "(1) the director was 'interested in the outcome' of the alleged self dealing transaction; or (2) 'lacked independence to consider objectively whether the transaction was in the best interest of the company and all its shareholders.'" n142 In *Hollinger,* the plaintiff alleged that defendants Black and Radler engaged in various self-dealing transactions, including receiving non-competition payments from Hollinger International, Inc. (International), selling International's assets at below-market prices to a corporation they controlled, loaning International's funds at below-market interest rates to a corporation they controlled, and receiving "'unwarranted, excessive, and unauthorized' 'management fees,' 'incentive payments,' and other compensation." n143 Defendant Perle was a director of International and sat on its audit, compensation, and executive committees. n144 At the same time, Perle was an officer of Digital Management, a company that plaintiffs alleged had received excessive fees for managing International's investments. n145

[*455] The district court found that the plaintiff had not alleged that defendant Perle had a direct financial interest in the transactions at issue, but had sufficiently pleaded lack of independence.

> To sufficiently plead "lack of independence," the plaintiff must allege "particularized facts" supporting "a reasonable inference" that the director was "beholden" to the controlling shareholder through a close personal, family, or business relationship. A director is "considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power . . . to decide whether the director continues to receive a benefit, financial or otherwise," which is of material importance to the director. n146

According to the court, because Black had appointed Perle CEO of Digital Management, a subsidiary of International, where Perle received over $ 3.1 million in incentive payments, the plaintiff sufficiently alleged that Perle lacked independence from Black. n147

The logical import from this reasoning is that a conflict of interest in the transaction, although a sufficient condition, is not a necessary condition to trigger a loyalty analysis. It would seem that other conflicts of interest, such as the lack of independence, would also violate the obligation to act with "an honor the most sensitive." This notion is consistent with *Disney II's* discussion of the "strict and unyielding" n148 terms of the duty of loyalty. *Disney II,* quoting *Guth v. Loft, Inc.,* n149 stated that "public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . ." n150 The court further stated that there must be "no conflict between duty and self-interest." n151 It would thus seem inconsistent with the reasoning of both *Disney II* and *Guth* to allow conflicts of interest, such as a lack of independence, to avoid judicial scrutiny when considering claims alleging breach of the duty of loyalty.

4. Independence in Shareholder Derivative Litigation

Given the significance of director independence in considerations of loyalty claims, it is instructive to consider the developing case law on independence [*456] in other areas of corporate law. For example, independence has become a significant concern in shareholder derivative litigation. n152

Boards may appoint special litigation committees ("SLCs") to make decisions regarding whether derivative litigation should be pursued or terminated. In *Zapata Corp. v. Maldonado,* n153 the Delaware Supreme Court articulated a two-step analysis for evaluating the decision of a special litigation committee. This analysis requires the court to evaluate the independence and good faith of the members of the special litigation committee and permits the court to use its own business judgment to determine whether it is in the best interest of the corporation for the suit to be either continued or terminated. n154

The lynchpin of the willingness of courts to defer to the special litigation committee is the independence of that committee. Recently, in *In re Oracle Corp. Derivative Litigation,* n155 the Delaware Chancery Court considered whether two special litigation committee members, both of whom were Stanford University faculty members and Oracle Corp. (Oracle) directors, were independent from the director defendants, who also bore significant ties to Stanford. The court noted that independence "'turns on whether a director is, *for any substantial reason,* incapable of making a decision with only the best interests of the corporation in mind.'" n156 In *Oracle,* the court noted the various ties defendant directors had with Stanford. n157 One defendant was a Stanford professor, had served with an SLC member at the Stanford Institute for Economic Policy Research (SIEPR), and had also taught one of the SLC members when the SLC member was a Ph.D. student at Stanford. n158 Another defendant was a Stanford alumnus who served as chair of the SIEPR board and who had directed millions of dollars in contributions to Stanford recently. n159 A third defendant donated millions [*457] of dollars to Stanford both directly through personal donations and indirectly through a foundation. He was also considering further donations of hundreds of millions of dollars around the time that the SLC members had been appointed to the corporate board. n160 These facts gave the court reasonable doubt concerning the independence of the SLC members. n161 The court further noted that the burden of proof rests with the SLC to establish its independence n162 and denied the SLC's motion to terminate the derivative litigation. n163 The ties among the SLC members and the defendants were, according to the court, so substantial that that they cast doubt about the impartiality of the SLC. n164

Independence was also at issue recently in *In re eBay, Inc. Shareholders Litigation.* n165 The court determined that demand was futile and permitted the litigation to proceed over the objection of the non-defendant directors who comprised the SLC. n166 The court was not convinced that the non-defendant directors on the SLC could "objectively and impartially consider a demand to bring litigation against those to whom [they are] beholden for [their] current and future position on eBay's board." n167 The court reached this conclusion after noting that the defendant directors owned enough stock to control the corporation and the election of directors, including the non-defendant directors on the SLC. n168 An additional concern was that the non-defendant directors owned options worth millions that had not vested and would not vest unless they continued to serve as directors of eBay. n169

These cases illustrate that various interests in the outcome or relationships with the parties involved may show the lack of independence of special litigation committees. These guideposts seem to have been reaffirmed in the *Disney II* court's discussion of the duty of loyalty. Citing precedent going back to 1939, *Disney II* emphasized that "[t]he rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest." n170

[*458] *C. Where Does Good Faith Fit In?:* Disney II

The Delaware Chancery Court recently opined on the relationship among the duties of care, loyalty, and good faith in *Disney II.* n171 According to *Disney II,* the duty of good faith is intertwined with the duties of care and loyalty:

> It does no service to our law's clarity to continue to separate the duty of loyalty from its essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement. There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally n172

The court outlined the three most salient violations of good faith. These include situations where (1) the fiduciary intentionally acts with a purpose other than advancing the best interests of the corporation; (2) the fiduciary acts with intent to violate positive law; or (3) the fiduciary intentionally fails to act in the face of a known duty to act. n173 The court noted that it is unclear whether a motive is required to successfully claim bad faith. n174

III. ERISA's FIDUCIARY STANDARDS

This Part begins by discussing the paradigmatic ERISA employer stock cases and their relationship to widely used employee benefit plans. It then turns to a brief discussion of the ERISA imposed fiduciary duty of loyalty. Finally, the Part engages in a detailed evaluation of the application of the duty of loyalty in the ERISA employer stock cases.

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

Most employees who have a pension plan through their employer are participants in a defined contribution plan. n175 Each employee has an individual [*459] account in the plan that enjoys favorable tax treatment, and the assets in the account belong to the employee. n176 Typically these plans are 401(k) or KSOP n177 accounts in which each employee makes an individualized decision on whether to make elective contributions to the plan, the employer may match some portion of the employee contributions, and each employee makes some or all of the decisions on how to invest the assets in the individual account. n178

During the past few years, these types of plans, which we refer to as company-sponsored employee investment plans, n179 have been subject to considerable litigation because of their use of employer stock as a required or optional investment vehicle. The majority of 401(k) plans sponsored by publicly held companies offer company stock as an investment option. n180 Employees are likely to hold assets, sometimes a substantial portion of their assets, in company stock in those plans. n181

The consistent fact pattern in the employer stock cases begins with a situation where some employees hold at least a portion of their plan account assets in employer stock. n182 The employer stock drops in value. n183 The employees who had invested in employer stock bring a class action suit alleging: (1) directors and others continued to offer company stock as a plan investment option, continued to make matching contributions in company stock, or continued to enforce plan rules prohibiting diversification out of employer stock at a time when the directors knew or should have known that the stock was not a prudent investment option; n184 (2) directors and others made materially inaccurate or incomplete disclosures regarding [*460] company stock; n185 or (3) directors and others failed to meet their obligations in appointing and monitoring other plan fiduciaries. n186 All three allegations raise issues involving the directors' fiduciary duty of loyalty. n187

B. ERISA's Fiduciary Duty of Loyalty

Pension funds give rise to agency problems that mirror the agency issues in corporate law. Regardless of the type of pension plan, n188 company officials, typically including members of the company's board of directors, oversee the plan and make critical decisions affecting the investment of assets or the available investment vehicles. Prior to the enactment of ERISA's extensive regulatory framework, fraud or underfunding of plans resulted in numerous situations where employees never received the benefits they expected. n189

In reaction to these and other concerns about agency issues affecting pension plan governance and investments, the drafters of ERISA explicitly adopted trust law standards in establishing a complex set of provisions governing the behavior of anyone who has discretion in administering or dealing with the assets of an employee benefit plan. First, all pension plan assets must be held in trust. n190 Second, the statute establishes a counterpart to the trust law duty of loyalty, requiring fiduciaries to act "solely in the interest of the participants and beneficiaries and ... for the exclusive purpose of... providing benefits to participants and their beneficiaries." n191

[*461] After establishing a duty of loyalty, however, ERISA's drafters backtracked and explicitly permitted fiduciaries to be conflicted by stating that the statute shall not be construed to "prohibit any fiduciary from serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest." n192 Arguably this departure from traditional trust law recognizes that employers have a special interest in the benefit plans they establish and may be reluctant to sponsor such plans if they are not permitted to retain a degree of control over the administration and investment of the plans. n193 Regardless of the reason for the provision permitting conflicted fiduciaries, the drafters of ERISA seemed to recognize the agency tensions inherent in the regime they were creating because they barred a wide variety of "prohibited transactions." n194

Harmonizing the realities of conflicted fiduciaries with the obligation of loyalty has not been simple, particularly given the variety of benefit plans governed by ERISA. A challenge for directors and other ERISA fiduciaries is to reconcile two lines of cases that flow from the conflicts of interest that ERISA allows. One strand of law imposes absolute loyalty on fiduciaries, setting a standard of an "eye single" to the interests of plan participants and beneficiaries. n195 This strand is consistent with traditional trust law and Justice Cardozo's famous language. n196 The other strand recognizes that employers may receive "'incidental' and thus legitimate benefits . . . from the operation of a pension plan." n197 This strand of the law is unique to ERISA and is compelled in part by the statute's approval of conflicted fiduciaries. It also recognizes that employers sponsor benefit plans, including company-sponsored employee investment plans, for a variety of [*462] self-interested reasons including decreasing employee turnover, competitive issues, and tax incentives. n198

Not only does ERISA depart from traditional trust law in its provisions for conflicted fiduciaries and specified prohibited transactions, but it also defines who is a fiduciary in terms more sweeping than trust law. Trust law contemplates that the typical trust will be managed by a single or small number of trustees. n199 In contrast, ERISA contemplates numerous fiduciaries for each benefit plan. An individual may become an ERISA fiduciary by being named as a "named fiduciary" n200 or by having the functional responsibility that brings with it fiduciary status. n201 Fiduciary status based on this functional definition, however, is limited "to the extent" the individual exercises or has discretionary authority over the functions that gave rise to the fiduciary status. n202 Plaintiffs in some employer stock cases have successfully alleged that company directors are functional fiduciaries because they have a measure of control over plan assets or because they appoint and monitor the actions of other plan fiduciaries. n203

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

The ERISA employer stock cases occupy a particularly important place in the development of the fiduciary obligation of loyalty. Few of the cases have progressed past the summary judgment phase, though most have permitted the plaintiffs to go forward on some claims. n204 At the same time, because of the litigation and potential liability involved with the use of employer stock in company-sponsored employee benefit plans, companies have begun to reconsider the use of employer stock in the plans. n205 This Section considers the fiduciary obligation of loyalty that inheres in such [*463] use of company stock in order to later contrast those obligations with directors' loyalty obligations to shareholders generally under corporate law.

1. Imprudence of Employer Stock as an Investment

Some typical claims made in the ERISA employer stock cases are that fiduciaries did not amend the plan (1) to eliminate company stock as an investment option; (2) to halt the employer matches in company stock; or (3) to permit employees to diversify their plan accounts out of employer stock even though the stock had become an imprudent investment. The most obvious statutory claim in these instances may be that the fiduciaries violated their fiduciary obligations of prudence and due care by failing to reconsider the use of company stock in company-sponsored employee investment plans once that stock became a problematic investment choice. In one such case, *In re WorldCom, Inc. ERISA Litigation,* the court denied the defendants summary judgment where the plaintiffs alleged that the fiduciary defendants failed to fulfill their responsibilities to evaluate the continued availability of WorldCom stock as an investment alternative under the plan. n206 More recently, the court in *DiFelice v. US Airways, Inc.* denied summary judgment to the company, which was the named trustee of the plan, in the face of the plaintiff's allegations that, given the obviousness of the company's financial distress, the company had an obligation to close the company stock fund in the plan and to end employees' ability to contribute to that fund on a certain date. n207 Even recognizing the latitude fiduciaries have in exercising their judgment on appropriate plan investments, n208 the court found that the numerous facts indicating the precarious nature of US Airways' financial situation could be sufficient to question whether the company had met its obligation of prudence. n209

The continued use of company stock also may breach the fiduciaries' duty of loyalty. One claim often raised by plaintiffs in the ERISA employer stock cases is a variant of the allegation that fiduciaries had conflicting interests in using company stock in the plan because either their compensation was stock-based or they owned substantial amounts of company stock. n210 In three cases in the Southern District of New York, plaintiffs' claims of this type failed to survive motions to dismiss. n211 In cases with similar facts, however, courts in the District of New Jersey and the Northern [*464] District of Georgia held that the plaintiffs had stated a claim for breach of loyalty. n212

In *In re Polaroid ERISA Litigation,* the court appeared to dismiss the conflict of interest claim because the existence of a compensation-based conflict was insufficient to establish a breach of loyalty. n213 The court in *In re WorldCom, Inc. ERISA Litigation* was more explicit. n214 The plaintiffs alleged that Bernard Ebbers, a WorldCom director as well as its President and CEO, breached his duty of loyalty by receiving stock-based compensation that created an incentive for him to keep the stock price high and ignore the best interests of plan participants and beneficiaries. n215 The court rejected the claim, relying on both ERISA's explicit provision for conflicted fiduciaries and its limitation of liability to only those acts taken while in the role of an ERISA fiduciary. n216 The plaintiffs had not shown that the conflict of interest caused Ebbers to act other than in the best interests of plan participants and beneficiaries when making decisions as a plan fiduciary. n217 In *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation,* the court took a slightly different approach to a similar claim that directors had sold their company stock while continuing to offer the stock as a plan investment. n218 The court ruled that the directors' personal sales of nonplan stock could not be considered a fiduciary act under ERISA because the sales were not undertaken as part of their administration or as investment of the plan assets. n219 As only functional fiduciaries, the directors could not be held liable under ERISA for acts taken outside their functional fiduciary roles. n220

In contrast, the district court in *In re Honeywell International ERISA Litigation* permitted the plaintiffs' breach of loyalty claim premised on a compensation-based conflict of interest to go forward. n221 The defendants had argued that ERISA's provisions for conflicted fiduciaries protected them and that fiduciaries' participation in stock-based compensation programs was not sufficient to state a breach of loyalty claim against them. n222 The court agreed with both arguments but declared that the defendants could "still be held liable for disloyalty if they acted in their own interests or the Company's, and against the interests of the Plan, while performing [*465] fiduciary duties." n223 The court had already decided that the plaintiffs had adequately alleged both misrepresentation of the company's financial position n224 and failure to change the availability of company stock in the plan after the stock became an imprudent investment. n225 These alleged actions were sufficient to support an inference that the fiduciaries had acted in their own or Honeywell's best interest while performing their fiduciary obligations. n226

Similarly, the plaintiffs' claim of conflict of interest survived a motion to dismiss in *Hill v. BellSouth Corp.* n227 The court found sufficient the plaintiffs' allegations that the defendants' participation in a stock-based compensation plan gave them an incentive to maintain the price of company securities and that two defendants, including the chairman of the Board of Directors, had personally sold company stock during the class period. n228 The *BellSouth* court did not articulate the standard it ultimately would use to determine whether the defendants breached their duty of loyalty, nor did it explicitly recognize ERISA's provision for conflicted fiduciaries. n229 But the court's statement that the plaintiffs had alleged that defendants "acted in a way that benefited them personally, yet did not protect the trust" may indicate that the fiduciaries' personal benefit will be important in the final determination. n230

In another variant, plaintiffs have argued that fiduciaries have breached their duty to avoid conflicts of interest, but the plaintiffs have declined to specify any particularized conflicts. The tension in these claims lies in determining the boundary between the statutory provision permitting conflicted fiduciaries n231 and a Supreme Court opinion that listed the "avoidance of conflicts of interest" n232 as being among the duties of an ERISA fiduciary. To date, courts have not articulated the extent to which fiduciaries must act affirmatively to avoid conflicts of interest tied to the use of employer stock. In *In re Dynegy, Inc. ERISA Litigation,* the plaintiffs argued that the fiduciaries should have hired an independent fiduciary to determine the prudence of company stock as an investment or notified the Department of Labor (DOL) of the circumstances that made investment in company stock imprudent. n233 The plaintiffs relied on Fifth Circuit precedent that:

> [*466] [t]he presence of conflicting interests imposes on fiduciaries the obligation to take precautions to ensure that their duty of loyalty is not compromised . . . "The level of precaution necessary to relieve a fiduciary of the taint of a potential conflict should depend on the circumstances of the case and the magnitude of the potential conflict." ... In some instances, the only open course of action may be to appoint an independent fiduciary. n234

The *Dynegy* court dismissed the plaintiffs' claim for failing to identify specific conflicts of interest and the harm those conflicts caused. n235 In *Pennsylvania Federation v. Norfolk Southern Corp.,* the plaintiffs alleged that the defendants violated their duty of loyalty by continuing to make matching contributions in plan stock and by precluding diversification in order to inflate the price of the stock while the company's financial performance was poor. n236 The court held that the defendants could not have violated their obligation of loyalty because they had followed the plan's terms regarding the investment of matching contributions. n237

In a decision contrasting with those of *Dynegy* and *Norfolk Southern,* the court in *In re Electronic Data Systems Corp. "ERISA" Litigation (EDS)* denied a motion to dismiss a nearly identical claim--because the fiduciaries operated under a conflict of interest they should have engaged an independent fiduciary or otherwise eliminated the conflict. n238 Although the plaintiffs had not argued that the fiduciaries' conflict resulted from stock-based compensation, the defendants contended that ERISA permits fiduciar-ies to take part in such compensation programs. n239 The court rejected this defense as an "attempt to place un-pled factual restrictions" on the plaintiffs' claim. n240 The court gave no hint as to whether the plaintiffs must ultimately prove direct benefit to the defendants at the plan's expense and did not otherwise discuss the standard for evaluating the plaintiffs' claim. n241

Finally, a quite different breach of loyalty claim may be predicated on the argument that a conflicted fiduciary must reconsider the use of company stock in a plan even though the plan terms require the use of such stock. In what is known as the settlor doctrine, the Supreme Court has determined that ERISA actors do not act in an ERISA fiduciary role when establishing, amending, or terminating a benefit plan. n242 Defendants have argued that, where the terms of the company-sponsored employee investment plan require the use of employer stock, the settlor doctrine protects [*467] them from having to reconsider the use of such stock and from any liability in failing to evaluate the stock's appropriateness as an investment alternative. n243 Courts have split over the extent to which the doctrine actually protects ERISA fiduciaries in such situations, but even where the fiduciaries have been held to an obligation to reconsider the use of company stock, the courts typically accord them a presumption of prudence. n244 The presumption in favor of the fiduciaries recognizes the policy considerations favoring the use of company stock and the liability a fiduciary might face by being overly cautious in revoking the use of company stock. n245

In *In re Honeywell International ERISA Litigation,* however, the court noted that the combination of a fiduciary's "conflicted status," knowledge of the impending collapse of the company, and a "precipitous decline in the price of employer stock" could be sufficient to overcome the fiduciary's presumption of prudence. n246 The courts have not clarified the weight to be accorded an opinion from an independent fiduciary that supports the defendants' actions nor have they announced a standard for evaluating the use of company stock when an independent fiduciary has made the usage determination. Elsewhere we have suggested that stricter scrutiny is appropriate in situations--such as the use of company stock--that present inherent conflicts of interest, and that one way to minimize those conflicts would be through the use of independent fiduciaries. n247

2. Failing To Properly Appoint or Monitor Plan Fiduciaries

Courts generally agree with the DOL's view that appointing plan fiduciaries is itself a fiduciary function and that it includes an obligation to monitor the appointed fiduciaries. n248 Plaintiffs who allege wrongdoing associated with investments in company stock frequently allege that corporate directors and others who have appointment authority over plan administrators, or plan investment committee members, failed in their obligation to properly appoint or monitor those lower level plan fiduciaries. n249 The [*468] claims can implicate the duties of prudence and care, but some are filed as claims for breach of duty of loyalty. n250

The plaintiff's contentions in *Howell v. Motorola, Inc.* n251 illustrate the complexities in these claims. The plaintiff alleged that defendants, who were directors of Motorola, breached their fiduciary duty, presumably the duty of loyalty, by failing to appoint plan fiduciaries who were independent and thus who were "influenced or controlled by the tacit or explicit direction of Motorola and/or the Director Defendants with respect to the management, investment and/or proposed or actual disposition of Plan assets." n252 The perceived lack of independence appeared to be grounded entirely in the fact that the appointed fiduciaries were Motorola employees. n253 The court was troubled because the claim appeared inconsistent with ERISA's provision permitting employees to act as fiduciaries; however, it decided that it did not yet need to reach the issue since the court found the plaintiff's failure to monitor claim sufficient to survive the motion to dismiss. n254

The director defendants in *Motorola* argued that they had no obligation to monitor those fiduciaries directly responsible for selecting plan investment vehicles and participant communications. n255 They contended that the duty of monitoring only arises where fiduciaries appoint "close business associates" such that the lower level fiduciaries have "clear conflicts of interest beyond their assumed loyalty to their employer." n256 Although it acknowledged some limited contrary authority, n257 the court found [*469] persuasive the DOL position and the clear weight of decisional authority that fiduciaries have an obligation to monitor all fiduciaries they appoint. n258

3. Material Misstatements and Omissions

Among its many provisions in addition to fiduciary regulation, ERISA sets forth specific disclosure obligations requiring plans to provide information to plan participants and beneficiaries, as well as to the DOL. n259 The Supreme Court has held that misrepresentations made in the course of plan administration violate ERISA's fiduciary duty of loyalty. n260 There is some trend in the ERISA case law to find that benefit plan fiduciaries have affirmative disclosure obligations even beyond those explicitly established in the statute and regulation. n261 Courts have developed this theory of expanded disclosure by looking to traditional trust law, which requires a fiduciary who knows that particular information would be of interest and value to a beneficiary to communicate that information. n262 According to those courts, failing to communicate material information that could "adversely affect a plan member's interests" violates an ERISA fiduciary's duty of loyalty. n263

Plaintiffs in the ERISA employer stock cases frequently allege that plan fiduciaries made, or permitted to be made, misstatements or omissions about the company's financial status and prospects and that those misstatements or omissions affected the plaintiffs' purchase or sale decisions. n264 [*470] Intentional misrepresentations made by ERISA fiduciaries would violate the standard that the Supreme Court established. To the extent case law supports an affirmative dissemination requirement, fiduciaries would also need to make appropriate disclosures related to company stock. Finally, as the plaintiffs in the *EDS* case argued, the duty to avoid conflicts of interest imposes on fiduciaries the obligation to make appropriate disclosures to plan participants and beneficiaries. n265 The *EDS* plaintiffs tied together an affirmative disclosure obligation, the duty of loyalty, and its alleged breach by arguing that as fiduciaries and "corporate officers they had both an incentive to conceal unknown information about EDS' stock value and a duty to reveal that information to Plan beneficiaries." n266 The allegation survived defendant directors' motion to dismiss. n267

IV. THE DEVELOPING DUTY OF LOYALTY

The corporate scandals of the late 1990s, the resulting public attention to corporate wrongdoing, the financial losses workers experienced in their 401(k) accounts, and the enactment of the Sarbanes-Oxley Act n268 have increased the public scrutiny of corporate directors. n269 Commentators have observed the resulting pressure brought to bear on Delaware corporate law to retain its position as the primary regulator of director responsibility to shareholders. n270 The numerous cases challenging fiduciary decisions regarding the use of employer stock in company-sponsored employee investment plans are forcing the federal courts to address directors' obligations in the ERISA context. n271

As a result of these pressures, jurisprudence on directors' duty of loyalty is developing along parallel tracks as Delaware courts interpret traditional state corporate law principles and federal courts interpret the statutory obligations imposed by ERISA. The concepts underlying the development of the duty of loyalty in these two fields are strikingly similar. Both fields trace their imposition of a loyalty obligation to the duty of loyalty [*471] established under trust law. n272 Although the duty of loyalty is applied in many contexts in both fields, state corporate law and the federal law of ERISA share the need to apply the duty of loyalty when fiduciaries make decisions regarding company stock. n273 In corporate law, for example, that obligation becomes important when a corporation is buying out minority shareholders or making decisions on merger and acquisition transactions. n274 In ERISA, the use of employer stock as an investment vehicle and a source of matching contributions for company-sponsored employee investment plans poses numerous loyalty considerations.

This Part analyzes and compares recent developments in the fiduciary duty of loyalty in Delaware corporate law and in federal law under ERISA. The continued shaping of the loyalty doctrine raises critical questions, particularly for corporate directors, who may be fiduciaries under both Delaware corporate law and ERISA. In what situations are directors considered to have a conflict of interest that matters for purposes of the duty of loyalty? What standards should be used to evaluate whether directors have violated the obligation of loyalty? What distinctions are developing between Delaware state law and federal law under ERISA? Are any diverging approaches, overlaps, or tensions firmly grounded in principle and not such that they impose inconsistent obligations on directors? This Part begins by considering the values to be served by a loyalty analysis. It then considers the categories of factual situations most likely to result in duty of loyalty violations. It next discusses the standards used to determine whether a loyalty violation has in fact occurred. It concludes by examining the determinants of liability for individual directors.

A. The Threshold Loyalty Analysis

A properly balanced duty of loyalty analysis performs three functions. First, it identifies those specific factual situations that create a serious threat of fiduciary wrongdoing and harm to those whose interests the fiduciaries are obligated to put first. Second, once such a factual situation has been identified, the analysis provides the legal standards to determine whether the fiduciary obligation of loyalty has been breached. Third, once a breach has been found the final step is to determine which individual fiduciaries are liable for that breach. Proper identification of those factual situations in which fiduciary violations are likely to occur ensures scrutiny of those transactions. At the same time it ensures that the vast majority of transactions that do not incorporate a high threat of fiduciary violation can proceed without the litigation and other costs that heightened scrutiny imposes.

[*472] The proper analysis must respond to the underlying dynamics of both corporate and ERISA law. If the threshold for when the presumption of the business judgment rule is set aside and the plaintiffs' claims survive a motion to dismiss is set too low, then the fears that that the *Smith v. Van Gorkom* n275 decision precipitated regarding the duty of care may come to pass: encouraging directors to be overly risk averse, discouraging qualified people from serving as directors, increasing the cost of insurance, and promoting excessive litigation. n276 The threshold must respect corporate law's traditional deference to the business judgment of directors. At the same time, it must consistently identify the factual

situations where directors will be most tempted to put their personal interests ahead of the interests of the shareholders. Once shareholders have adequately alleged the necessary facts, then scrutiny of the transaction in question must be serious enough to address the specific situation and to protect the integrity of corporate governance generally by discouraging other directors from profiting at the expense of shareholders.

In company-sponsored employee investment plans that utilize employer stock, the need to develop a properly sensitive standard for when to use enhanced scrutiny is equally complex. ERISA permits both interested fiduciaries and the use of employer stock. n277 Imposing too low a standard for when scrutiny will be applied could doom the use of employer stock in these plans. Conversely, imposing too high a standard could leave plan participants unprotected in the face of fiduciaries who profit directly or indirectly at their expense. Thus, proper identification of those factual situations that deserve enhanced scrutiny and the extent of that scrutiny are both outcome determinative and critical for the sponsorship of the company-sponsored employee investment plans.

B. Identifying Potential Violations of the Duty of Loyalty

The initial consideration in analyzing duty of loyalty claims should be determining whether it is likely, given the facts, that a violation has occurred. By engaging in scrutiny when, and only when, the factual situation is one that is likely to have given rise to a duty of loyalty violation, the analysis protects the majority of transactions from the costs of scrutiny while ensuring that the transactions that carry with them a high risk of violations are properly reviewed. One category of transactions long understood to [*473] threaten the integrity of traditional trusts occurs when trustees operate under a conflict of interest. n278

Theoretically, an individual's mere status as a corporate director creates a conflict of interest because directors receive fees from the company for their service and the prestige associated with such a position may be generally career enhancing. However, treating every director as conflicted in every corporate transaction would effectively nullify the business judgment rule, decrease directors' risk tolerance for transactions, burden the court system, and discourage individuals from accepting directorships. n279 One ERISA provision acknowledges that imposing an extensive loyalty analysis on each plan-related decision made by officers, employees, and agents would burden their ability to serve as fiduciaries. n280 Clearly, for both Delaware corporate law purposes and federal ERISA purposes, the bar for a conflict of interest that gives rise to fiduciary scrutiny must be set higher than mere status as a corporate director.

1. Requirement of Finding a Self-dealing Conflict of Interest in the Transaction Itself

The chancery court in ECM speculated that a loyalty breach may require the director to have "a self-dealing conflict of interest in the transaction itself." n281 This standard, if Delaware were to adopt it, would establish too high a threshold for when conflicts rise to the level that triggers scrutiny for loyalty violations. For example, *ECM* was unusual in that it was presented as both an appraisal case and a case of generalized fiduciary breach claims. The chancery court easily determined that the fiduciary claims met the threshold for review under the entire fairness standard because the privatization was without question a self-dealing transaction. n282 The court's concern that "a self-dealing conflict of interest in the transaction itself" is required for a breach of loyalty arose only in the final step of analysis--the determination of individual liability. n283 The implication, however, is that [*474] if such a conflict is necessary for individual liability under the duty of loyalty, then it also would be necessary as a threshold matter for the plaintiffs seeking scrutiny beyond the business judgment rule. The potential precedent from this latter approach based upon *ECM*, even in light of the seemingly inconsistent language in *Disney II*, concerns us here.

The chancery court's language on the potential need for "a self-dealing conflict of interest in the transaction itself" n284 appears to require a two-part inquiry. The plaintiffs presumably would need to establish both that the conflict resulted in self-dealing and that the self-dealing was part of the transaction in question. Self-dealing would include any benefit the directors would ultimately receive other than retention of directorships. If directors derived the benefit as a result of a vote on or other involvement with a transaction, then the benefit could give rise to a conflict that would fit within the court's language.

A careful examination of the *ECM* court's application of its articulated standard implies, however, that it contemplates a higher bar for conflicts. When it got to the stage of determining individual liability, the court found that Raynor voted to approve the price of $ 10.25 per share to avoid opposing Prosser because "Raynor's economic interests were tied solely to Prosser and he acted to further those economic interests." n285 In the very next sentence, the court held that Raynor had violated his duty of "loyalty and/or good faith," n286 and attributed its inconclusiveness to its concern that

Delaware law might require "a self-dealing conflict of interest in the interest in the transaction." n287 If that were the standard for a loyalty violation, the court believed that Raynor would not have violated his duty of loyalty.

The only way to understand the *ECM* court's analysis is that either the personal "economic interests" Raynor had pursued via his vote did not constitute "self-dealing" or the self-dealing was not sufficiently connected to the transaction to meet the articulated standard. It appears that the court's concern was the latter. By its statement that "Raynor did not benefit directly from the transactions," n288 the court implied that, in the absence of the direct gain to Prosser, a potential financial quid pro quo to Raynor in return for his vote in favor of the $ 10.25 share price transaction would not sufficiently become part of the transaction to avoid the business judgment rule and give rise to scrutiny of the transaction for a loyalty violation.

[*475] Understood in this way, the court's analysis is troubling. If Raynor had owned ECM stock and benefited financially from the unfairly low purchase price imposed on the minority shareholders, then Raynor's benefit would meet both the self-dealing requirement and the need for the self-dealing to be "in the transaction itself." n289 It is appropriate that minority shareholders receive the protection of scrutiny for compliance with a director's duty of loyalty when the director financially benefits in such a direct way. But, the actual facts also could cause significant loyalty concerns for ECM's minority shareholders. If Raynor in fact derived significant economic gain, or avoided a significant economic harm, as a quid pro quo for his vote in favor of the $ 10.25 share price transaction, then it does not seem as though the minority shareholders would care that the financial benefit, or avoidance of loss, came from a source other than Raynor's stock ownership in ECM. Either way, his personal financial interests caused Raynor to vote for a transaction that the court eventually found was not fair to the minority shareholders. n290 The source of the funds giving rise to the conflict of interest does not reduce the risk to the minority shareholders; nor does it alter the underlying agency concern. Trustees with conflicts of interest will all too often neglect the best interests of the beneficiary in favor of their own interests. n291

The implications of the *ECM* analysis for ERISA employer stock cases further reveal the defects in the court's analysis. One typical allegation is that directors and other fiduciaries violate their duties by permitting the continued use of company stock as a voluntary or mandated investment vehicle or the use of company stock as the employer's matching contribution. n292 The approach courts currently use to evaluate what factual allegations are sufficient to survive a motion to dismiss and give rise to scrutiny of the directors' decisions depends in part on whether the plan terms require the use of employer stock. n293

The notion that, in order to survive a motion to dismiss, plaintiffs in ERISA employer stock cases must allege a "self-dealing conflict of interest in the transaction itself" arguably draws some support from the case law indicating that fiduciaries only have fiduciary obligations to the extent they act as fiduciaries. n294 The traditional import of this well-developed doctrine is to protect fiduciaries from liability when they make business decisions that may cause harm to the interests of benefit plan participants or beneficiaries. n295 The doctrine also protects fiduciaries in circumstances [*476] where the fiduciaries make settlor decisions about the plan. n296 In the former situation, the fiduciaries might make a poor business decision that causes the company's profits to drop and thereby reduces the company's contribution to an ERISA profit sharing plan. The poor business decision would harm the ERISA plan participants and beneficiaries but would not give rise to any kind of ERISA fiduciary violation because the directors did not make the business decision in their capacity as ERISA fiduciaries. Or, the fiduciaries might modify prospectively the terms of a plan to decrease participant benefits and make the firm more competitive. That decision would harm participants but would be protected by the settlor doctrine. n297

It might seem that a director's decision to use company stock in a benefit plan would easily constitute a potential conflict in the transaction itself. However, an established presumption in Employee Stock Ownership Plan (ESOP) law complicates this analysis. *Moench v. Robertson*, an ESOP case from the Third Circuit, established that when the benefit plan's terms require the use of employer stock, the plan's fiduciaries enjoy a presumption of prudence in favor of their decision to use and continue the use of employer stock in the plan. n298 According to *Moench*, fiduciaries enjoy a presumption of prudence for investments in employer stock, but the plaintiffs may rebut the presumption by showing that "circumstances not known to the settlor and not anticipated by him [in the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust." n299 In a further refinement, it appears that, at least in some jurisdictions, plaintiffs must prove that "the company is on the brink of collapse or undergoing serious mismanagement" in order to rebut the *Moench* presumption. n300 ESOPs differ from the 401 (k) plans that typify the ERISA employer stock cases because ESOPs are statutorily required to invest primarily in employer stock whereas no such provision exists for standard 401(k) plans. n301 Courts deciding ERISA employer stock cases could have distinguished *Moench* on this basis, but multiple courts have applied the *Moench* presumption when analyzing a 401(k) plan fiduciary's prudence. n302 While the *Moench* presumption only explicitly governs the duty of care, n303 not loyalty, the use of the presumption could help explain the [*477] skepticism with which some courts have approached the plaintiffs' loyalty claims. Interestingly, courts are split on whether the presumption should be applied at the motion to dismiss stage. n304

Even when plan terms do not require the use of company stock, a rote application of the *ECM* court's "transaction itself" standard could lead to the sort of nonsensical analysis performed by the district court in *In re AOL Time Warner, Inc., Securities and "ERISA" Litigation.* n305 Assume directors of Company *A* sell their personal Company *A* stock and, at the same time, continue unchanged the use of Company *A* stock in the company-sponsored employee investment plan as an optional investment vehicle and as the form of the company's matching contributions. Assume also that the directors do not participate, as outside directors typically would not, in the plan. Instead, the directors' Company *A* stock holdings are held in personal accounts unaffiliated with any company-sponsored plan. Assume, finally, that the directors decided not to make any change to the plan's use of Company *A* stock and not to communicate business concerns with participants or beneficiaries solely because the directors wanted to support the price of Company *A* stock while they sold their own holdings. Such a scenario raises egregious duty of loyalty concerns.

Whether application of the *ECM* court's logic and the "self-dealing conflict in the transaction itself" standard to the foregoing situation would permit the plaintiffs to get beyond the motion to dismiss stage, however, depends on how the "transaction itself" requirement is interpreted. Like Raynor, the directors enjoyed a personal benefit--the sale of their own Company *A* stock. There are two transactions that one might look at for the "transaction itself": the personal sale of the Company *A* stock or the plan-related decision. The *AOL Time Warner* court focused on the directors' sales of their personal securities as the transaction in question and dismissed the plaintiffs' loyalty claims because directors do not act as plan fiduciaries when they sell their own non-plan stock. n306

The claims of the *AOL Time Warner* plaintiffs, however, should not have been evaluated as alleging an ERISA violation and loss based upon the directors' sale of their own securities. Instead, the alleged violation and loss resulted from the directors' decision to continue using company stock in [*478] the plan. n307 Similarly, in the hypothetical Company *A* situation, the "transaction itself" that matters would be the directors' decision not to change the plan's use of Company *A* stock and not to communicate concerns regarding the stock to the plan participants and beneficiaries. Assuming the directors did not own any stock held by the plan, one analysis would conclude that the directors' personal financial interests were not derived from the "transaction itself," if "transaction" is defined as the plan's continued use of company stock. Instead, the directors' gain came from the unrelated transactions of their personal stock sales. That would logically lead to dismissal of the plaintiffs' case.

An alternative approach that would distinguish the *ECM* situation and find a sufficient conflict in the Company *A* situation would be to focus on the directors' ownership of Company *A* securities, their self-dealing gains derived from Company *A* securities, and the transaction--the decision regarding plan use of Company *A* securities and communication--related directly to the price of Company A securities. Therefore, the relationship between the gain and the transaction could be direct enough to support a finding of a conflict of interest and a need for scrutiny. In such a situation, as has occurred in a number of the actual ERISA employer stock cases discussed above, where the directors' gains were derived from stock-based compensation, n308 a finding of a conflict of interest in the Company *A* hypothetical would depend on the application of the *ECM* court's analysis. n309

2. An Alternative: A Substantial Lack of Independence

As an alternative to requiring a self-dealing conflict in the transaction at issue, the courts should recognize that a sufficient lack of independence should trigger scrutiny to ensure a fiduciary has complied with the duty of loyalty. This alternative would appropriately expand beyond the cramped *ECM* approach the types of factual allegations that give rise to scrutiny in line with the approach used in most Delaware cases. n310 For example, the lack of independence would have been sufficient, under the reasoning of the courts in *Orman* and *Hollinger,* n311 to give rise to a potential violation of the duty of loyalty and typically would shift the burden of proof to defendants to prove the entire fairness of the transaction. The *Oracle* court articulated the substantial lack of independence as follows: "The question of independence 'turns on whether a director is, for any substantial [*479] reason, incapable of making a decision with only the best interests of the corporation in mind.' That is, the independence test ultimately 'focus[es] on impartiality and objectivity.'" n312

Application of a lack of independence standard would be more complicated in ERISA cases because the statute authorizes conflicted fiduciaries. n313 That authorization, however, is not without boundaries. In addition to the existence of the statutory loyalty provision, the prohibited transactions requirements and the Supreme Court's statement that a basic duty of ERISA fiduciaries is to avoid conflicts of interest serve to limit the acceptance of actions by conflicted fiduciaries.

n314 The Supreme Court has also written that conflicts of interest, presumably including a lack of fiduciary independence, should increase the scrutiny given to fiduciaries' interpretation of plan terms. n315 The same logic should require scrutiny for compliance with loyalty when fiduciaries make decisions about the use of employer stock while operating under a substantial lack of independence.

In sum, both Delaware corporate law and the federal law of ERISA rely on the fiduciary obligation of loyalty to prevent self-interested fiduciaries from acting to their own advantage and to the detriment of the shareholders or plan members. It is critical that each legal regime establish a threshold for factual allegations that will give rise to scrutiny of transactions perceived as potential loyalty violations. The Delaware Chancery Court has appropriately recognized that either self-dealing in the transaction or a substantial lack of independence could result in scrutiny. n316 The *ECM* courts' analysis potentially, and unwisely, puts that jurisprudence in question.

Beyond the *Moench* presumption of prudence, n317 which is troubling in itself, the ERISA employer stock cases have not established any clear guidance as to what factual allegations present a threat of fiduciary breach of loyalty. Development of a standard would give guidance to fiduciaries. It would also increase the predictability and efficiency of litigation. The corporate law standards of permitting review where the plaintiffs sufficiently allege self-dealing in the transaction or a substantial lack of independence provide a reasonable starting point for the development of an ERISA standard. Finally, the independence standard respects principles of trust law while giving meaningful deference to fiduciaries.

[*480] *C. The Duty of Loyalty Analysis*

Where plaintiffs sufficiently allege either self-dealing in the transaction or a substantial lack of independence, the next step is to determine the standard to be applied to analyze whether breach of loyalty has occurred. This Section compares Delaware corporate law's entire fairness standard to the approach in the ERISA employer stock cases.

Case law has long held that a corporate action in a company stock transaction would be evaluated using the entire fairness standard. n318 The burden of proof would shift to the conflicted directors to convince the reviewing court that the transaction met both fair price and fair dealing requirements. If the directors did not meet their burden of proof in either prong of the analysis, the court would find a breach of the directors' duty of loyalty. n319 The directors may shift the burden of proof back to the plaintiffs by showing the transaction was approved by a fully informed independent committee of disinterested directors or an informed vote of a majority of the minority shareholders. n320

As noted above, in *ECM*, the court held that the burden of proof remained with the defendants. n321 Although the directors' independence was in question, the court held that the problem with the special committee's approval of the transaction was that the committee had not received the company's most recent financial projections and was therefore insufficiently informed. n322 Similarly, the vote of the minority shareholders was considered uninformed because they had not received those projections. n323

In its fair dealing analysis, the court considered factors such as how shareholder approval was obtained, and how the transaction was timed, initiated, structured, negotiated, and disclosed to the board. n324 The court found that the *ECM* transaction was unfair in all these aspects. n325 Moreover, the court noted that a critical aspect of the fair dealing analysis is the adequacy of the representation of the minority shareholders. n326 The court found that neither the majority of the ECM board, nor the special committee it appointed to negotiate for the minority shareholders, was independent, and thus, the interests of the minority shareholders were not adequately represented. n327

[*481] No standard equivalent to the entire fairness standard has emerged in the ERISA employer stock cases. As a general rule, however, the *Employee Benefits Law* treatise states: "Dealing with plan assets in order to further one's own interests rather than those of the plan clearly violates the exclusive benefit rule." n328 Case law outside the ERISA employer stock context adds texture to this principle.

In one case, officers of a company defending against a hostile takeover were also retirement plan fiduciaries. n329 The fiduciaries caused the plan to purchase additional company stock and not to tender any of the stock in the plan. n330 Their actions violated their duty of loyalty to the plan and its participants. n331 The court recognized that some defendants had no assurances of employment after the acquisition or would have diminished roles in the merged entity. n332 The court found that the officers had treated their plan obligations "quite casually" n333 and suggested that the fiduciaries should have obtained independent advice. n334 The court also criticized the fiduciaries for not fully informing themselves about the circumstances of the pension plan and the effect of the company stock investments on the plan. n335 Absent these actions, the court concluded that the fiduciaries had not done enough to ensure the security of the employee benefit plans. n336

Similarly, in cases not involving company stock, courts have found ERISA loyalty violations where fiduciaries used plan assets to benefit their individual interests. In *Marshall v. Carroll*, the Secretary of Labor alleged that the defendant fiduciaries, an individual and companies he had financial interests in, had breached a variety of fiduciary duties and violated ERISA's prohibited transactions requirements. n337 The defendants had caused plan assets to be invested in a deposit administration group annuity contract, which had terms less favorable to the plans than alternative investments but provided excessive commissions to the defendant fiduciaries. n338 In addition, the defendant fiduciaries had deposited significant sums of plan assets in banks, which in return provided loans to the fiduciaries. n339 The court held that both sets of transactions violated the fiduciaries' duty of loyalty. n340

[*482] The ERISA jurisprudence appears to concentrate its loyalty inquiry on an analysis similar to the fair dealing prong of Delaware's entire fairness standard. In the context of ERISA company stock cases, this would require review of a number of relevant factors in the same way the fair dealing analysis looks at a variety of factors. n341 To fulfill their loyalty obligations, fiduciaries must at relevant times: consider the plan's use of company stock; act appropriately to minimize their conflicts of interest, for example, by obtaining independent advice on the use of company stock; and ensure that the fiduciaries responsible for deciding on the use of company stock receive all reasonably available information relevant to the decision. n342 If plan participants have options involving investment in company stock, they also must receive all reasonably available information relevant to their decision. n343

The foregoing comparison of the standards used in Delaware corporate law and in the ERISA employer stock cases reveals that Delaware law is more developed and nuanced in this area. Federal district courts are only beginning to evaluate fiduciary actions for duty of loyalty violations in the ERISA employer stock cases, whereas Delaware courts have long subjected corporate fiduciaries to scrutiny for lapses of loyalty in company stock transactions in the general corporate context. Given the equivalent theoretical underpinnings of the two doctrinal areas--both trace their development and application of the duty of loyalty to traditional trust law--Delaware corporate law logically serves as a model for federal courts' ERISA analysis.

One important difference between the two regimes, though, lies in ERISA's explicit provision for conflicted fiduciaries. n344 In contrast, Delaware corporate law encourages decisions by disinterested directors by providing those directors with the benefit of the business judgment rule and, in turn, subjecting interested directors to the enhanced scrutiny of the entire fairness rule. n345 Another distinction militating in favor of some flexibility [*483] in the standard applied to ERISA fiduciaries is the provision in ERISA and the Internal Revenue Code that favors the use of company stock in benefit plans. n346 It would be troubling for federal law to encourage the use of company stock in benefit plans and then to always subject plan fiduciaries to enhanced scrutiny in determining whether they met their fiduciary duty of loyalty when making company stock-related plan decisions.

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

D. The Individual Liability Analysis

The third analytical step taken by the *ECM* court was to determine the liability of individual directors: "The liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director." n347 This is the point at which the court made alternative findings that directors Raynor and Muoio were liable for breaching the "fiduciary duty of loyalty and/or good faith." n348 The existence of a loyalty violation, according to the court, depended on whether a breach of loyalty requires "a self-dealing conflict of interest in the transaction itself." n349

Such a cramped view of the loyalty analysis has no grounding in prior Delaware law, nor is it consistent with the principles underlying the duty of loyalty. Most of Delaware's loyalty jurisprudence has been developed in the context of the threshold analysis discussed above. n350 It appropriately recognizes that either self-dealing in the transaction or a substantial lack of independence can give rise to scrutiny of the directors' decision. n351

A more limited standard for the determination of individual liability would be irrational. Assume, for example, that a court finds it appropriate to scrutinize a transaction for loyalty because the directors responsible for [*484] the decision were not sufficiently independent. Suppose too that the court finds the transaction itself does not withstand the entire fairness inquiry. If the cramped *ECM* standard is used and no directors have a self-dealing conflict of interest in the transaction then no director would be individually liable. This result would hold true even if the directors clearly were not independent and personally benefited in indirect ways from their approval of the transaction. Surely, such a result is inconsistent with the principles undergirding the duty of loyalty.

In the ERISA context, separately evaluating the individual liability of fiduciaries is consistent with the understanding that an ERISA fiduciary's liability is limited to acts undertaken as a fiduciary. The individualized inquiries in the ERISA employer stock cases, though, are likely to require evaluation of the actions of a large number of fiduciaries, from the board of directors down to the committee members responsible for plan investments. Regardless of the number of relevant fiduciaries, it is as important in this context as in the general corporate arena that the situations that give rise to a breach of loyalty not be artificially constrained. Here too the possibility for self-interested decision making arises from a substantial lack of independence as well as from a self-dealing conflict in the decision regarding the use of company stock.

V. CONCLUSION

Cases like *Disney II, n352 ECM, n353 Enron, n354 and US Airways* n355 show that the fiduciary duty of loyalty has developed far beyond its historical role as a mechanism governing testamentary trusts. Loyalty now plays a critical role in protecting the capital structure of corporations and the involvement of employers in the benefit plans they sponsor by ensuring that those with power over corporate funds and benefit plan decision-making are not tempted to profit at the expense of those they serve.

As duty of loyalty jurisprudence continues to develop during the current era of recovery from corporate scandal and of sensitivity to employees who have seen their retirement dreams fade along with their 401(k) account balances, the doctrine must strike a balance. The doctrine cannot hold fiduciaries liable for merely being fiduciaries. In the corporate context, the *Disney II* court articulated a strong standard of loyalty. n356 The court reiterated that "there is no safe-harbor for divided loyalties in Delaware" n357 and applied the loyalty standard in a way that recognized the realistic limits on corporate decision-making and the danger of arguments based [*485] on hindsight. In contrast, corporate cases like *ECM* have appeared to set arbitrary standards for fiduciary analysis. n358 The doctrine cannot be so cramped as to ignore fact patterns that raise valid loyalty concerns. Similarly, in the context of whether fiduciary compensation can affect breach of loyalty analysis, the courts in *In re Polaroid ERISA Litigation, n359 In re WorldCom, Inc. ERISA Litigation,* n360 and in *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation,* n361 have taken a very narrow view. While predictability of outcome is valuable, fiduciary analysis has always been flexible in an effort to protect the relatively powerless from the self-dealing of those they have trusted to act on their behalf. The goal should not be to develop an arbitrary, bright-line approach that relies on a particularized type of conflict of interest. Instead, *Disney II* correctly required that corporate directors take seriously the duty of loyalty they owe to corporate shareholders. The standard for the duty of loyalty can be both strong and flexible, scrutinizing both self-dealing and a lack of independence.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesDuty of LoyaltyEstate, Gift & Trust LawTrustsGeneral OverviewGovernmentsFiduciary Responsibilities

FOOTNOTES:

n1 Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

n2 *Id.*

n3 *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004). The case is best known because one director with substantial expertise in finance and the telecommunications sector was held, at least in part because of that expertise, to have violated his duty to shareholders. *See* Harvey L. Pitt. *The Changing Standards by Which Directors Will Be Judged,* 79 ST. JOHN'S L. REV. 1, 3-5 (2005); E. Norman Veasey, *Musings from the Center of the Corporate Universe,* 7 DEL. L. REV. 163, 172 (2004).

n4 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *142 n.184.

n5 *In re* Walt Disney Co. Derivative Litig. (*Disney II*), No. 15452, 2005 Del. Ch. LEXIS 113, at *169 n.447 (Del. Ch. Aug. 9, 2005).

n6 *See Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70.

n7 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and other titles (2000)).

n8 *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995).

n9 Employee Retirement Income Security Act (ERISA) of 1974 § § 1-4402, 29 U.S.C. § § 1001-1461 (2000).

n10 *See infra* notes 175-187 and accompanying text.

n11 *See infra* notes 175-187 and accompanying text.

n12 *Disney II*, 2005 Del. Ch. LEXIS 113; *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70.

n13 *See infra* notes 175-187 and accompanying text.

n14 29 U.S.C. § § 1001-1461.

n15 RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959). Trust law imposes an array of other obligations on trustees in addition to loyalty. *See* Dana M. Muir, *Fiduciary Status As an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391,396 (2000).

n16 RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 183 ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

n17 John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 938-39 (2005).

n18 *Id.* at 931.

n19 *Id.* at 934.

n20 *Id.* at 963-79 (describing the three exclusions to the sole interest rule: settlor authorization, beneficiary consent, and advance judicial approval).

n21 *Id.* at 933-34.

n22 Langbein, *supra* note 17, at 933-34.

n23 *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 931 (Del. 2003); Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Alessi v. Beracha, 849 A.2d 939, 950 (Del. Ch. 2004) ("[F]iduciary duties are owed by the directors and officers to the corporation and its stockholders." (quoting Arnold v. Soc'y for Sav. Bancorp, 678 A.2d 533, 539 (Del. 1996)); Dennis v. Copelin, 669 So. 2d 556, 560 (La. App. 4 Cir. 1996); Chambers v. Beaver-Advance Corp., 392 Pa. 481, 486 (1958); Victor Brudney, *Contract and Fiduciary Duty in Corporate Law,* 38 B.C. L. REV. 595, 595 (1997); *see also* WILLIAM E. KNEPPER ET AL., LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.07 (7th ed. 2003); J. C. SHEPHERD, THE LAW OF FIDUCIARIES (1981); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance,* 75 IOWA L. REV. 1 (1989); D. Kyle Sampson, *The Fiduciary Duties of Corporate Directors to "Phantom" Stockholders*, 62 U. CHI. L. REV. 1275, 1276 (1995). *But see* John C. Carter, *The Fiduciary Rights of Shareholders,* 29 WM. & MARY L. REV. 823, 824 (1988) ("Although courts commonly speak of a fiduciary duty of directors to the corporation and its shareholders, one is hard pressed to find a case in which directors are held directly liable to shareholders, absent circumstances that create a special relationship.").

n24 One of the earliest cases discussing the duty of care in the United States is Percy v. Millaudon, 8 Mart. (n.s.) 68, 74-75 (La. 1829).

n25 *See infra* notes 171-174 and accompanying text for a discussion of the obligation of good faith.

n26 *See, e.g.*, Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers,* 77 YALE L.J. 1078, 1099-1100 (1968) (finding only four such cases); Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 592 n.2 (1983) (finding only six cases in which directors of industrial corporations had been held liable to a standard of negligence); *see also* Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule,* 19 DEL. J. CORP. L. 971 (1994) (tracing the development of the duty of care in Delaware).

n27 Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

n28 *See* Joseph Hinsey IV, *Business Judgment and The American Law Institute's Corporate Governance Project: The Rule, the Doctrine, and the Reality,* 52. GEO. WASH. L. REV. 609, 610 (1984).

n29 Section 102(b)(7) of the Delaware Code provides that the articles of incorporation may include:

> A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.

DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

n30 The following statutes are similar to Section 102(b)(7) in Delaware: ALA. CODE. § 10-2B-2.02(3) (1999); ALASKA STAT. § 10.06.210(1)(N) (2004); ARIZ. REV. STAT. ANN. § 10-202(B) (2004); ARK. CODE ANN. § 4-27-202(b)(3) (2001); CAL. CORP. CODE § 204(a)(10) (Deering 2003); GA. CODE ANN. § 14-2-202(b)(4) (2003); IDAHO CODE § 30-1-202(2)(d) (2005); 805 ILL. COMP. STAT. 5/2.10(b)(3) (2004); IOWA CODE ANN. § 490.202(d) (West Supp. 2005); KAN. CORP. CODE ANN. § 17-6002(b)(8) (West Supp. 2005); KY. REV. STAT. ANN. § 271B.2-020(2)(d) (West 2003); LA. REV. STAT. ANN. § 12:24(c)(4) (1994 & Supp. 2006); MASS. GEN. LAWS ch. 156B, § 13(b)(1 1/2) (2005); MICH. COMP. LAWS § 450.1209(c) (2002); MINN. STAT. § 302A.251(4) (2004); MISS. CODE ANN. § 79-4-2.02(b)(4) (West 1999); Mo. REV. STAT. § 351.055(2)(3) (Supp. 2004); MONT. CODE ANN. § 35-1-216(2)(d) (2005); NEB. REV. STAT. § 21-2018(2)(d) (1997); N.M. STAT. § 53-12-2(E) (Supp. 2003); N.Y. Bus. CORP. LAW § 402(b) (McKinney 2003); N.C. GEN. STAT. § 55-2-02(b)(3) (2005); N.D. CENT. CODE § 10-19.1-50(5) (2001); OKLA. STAT. ANN. tit. 18, § 1006(B)(7) (West 1999 and Supp. 2006); OR. REV. STAT. § 60.047(2)(d) (2003); R.I. GEN LAWS § 7-1.2-202(b)(3) (Supp. 2005); S.C. CODE ANN. § 33-2-102(e) (1990); S.D. CODIFIED LAWS § 47-2-58.8 (2000); TENN. CODE. ANN. § 48-12-102(b)(3) (2002); TEX. REV. CIV. STAT. ANN. art. 1302-7.06, § B (Vernon 2003); VT. STAT. ANN. tit. 11A, § 2.02(b)(4) (1997); W. VA. CODE ANN. § 31D-2-202(4) (LexisNexis 2003); WYO. STAT. ANN. § 17-16-202(b)(iv) (2005). The following statutes also provide liability protection for officers: LA. REV. STAT. ANN. § 12:24(C)(4) (1994 & Supp. 2006); ME. REV. STAT. ANN. tit. 13-C, § 202(2)(D) (2005); MD. CODE ANN., CORPS. & ASS'NS § 2-405.2 (LexisNexis 1999); NEV. REV. STAT. § 78.138(7) (2003); N.H. REV. STAT. ANN. § 292:2(V-a) (1999); N.J. STAT. ANN. § 14A:2-7(3) (West 2003); VA. CODE ANN. § 13.1-692.1 (1999). Exculpation is provided automatically by FLA. STAT. § 607.0831 (2005); IND. CODE § 23-1-35-1(e) (1998); OHIO REV. CODE ANN. § 1701.59(c) (West 1994 & Supp. 2004). Wisconsin automatically provides for exculpation, unless the corporation provides otherwise. WIS. STAT. § 180.0828 (2003-04). The following statutes permit exculpatory language in the corporate bylaws. HAW. REV. STAT. ANN § 414-32(5) (LexisNexis 2004); UTAH CODE ANN. § 16-10a-841(1) (2005); VA. CODE ANN. § 13.1-692.1 (1999).

n31 *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 825 A.2d 275, 291 (Del. Ch. 2003).

n32 746 A.2d 244, 248 (Del. 2000).

n33 *Disney I,* 825 A.2d. at 289 (emphasis omitted).

n34 *Id.* at 287.

n35 *In re* Walt Disney Co. Derivative Litig. (*Disney II*), No. 15452, 2005 Del. Ch. LEXIS 113, at *245 (Del. Ch. Aug. 9, 2005).

n36 *Id.* at *158 (quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125. 130 (Del. 1963)).

n37 *Id.* (quoting Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000)).

n38 *Id.* at *159.

n39 *Id.* at *176.

n40 *Disney II*, 2005 Del. Ch. LEXIS 113, at *160 (quoting *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967-68 (Del. Ch. 1996) (citations, emphasis and footnotes omitted)).

n41 *Id.* at *161.

n42 *Id.* at *3.

n43 *Id.* at *4.

n44 *Id.*

n45 No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004).

n46 *See, e.g.,* Horsey, *supra* note 26, at 973; Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 Nw. U. L. REV. 651, 651 (2002); L. S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 70 (1962); Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law,* 27 J. CORP. L. 333 (2002).

n47 *See* SHEPHERD, *supra* note 23, at 98.

n48 RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 2 cmt. b.

n49 *See* Sealy, *supra* note 46, at 71-72 ("The word fiduciary (which earlier had received very little judicial support) was adopted to describe these situations which fell short of the now strictly-defined trust." (footnote omitted)); *see also* Walsh, *supra* note 46, at 334.

n50 *See* Horsey, *supra* note 26, at 974; Walsh, *supra* note 46, at 334.

n51 *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests." (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939))); *see also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) ("[D]irectors must eschew any conflict between duty and self-interest."); Walsh, *supra* note 46, at 334. Most states have codified the duty of loyalty. *See* ALA. CODE § 10-2B-8.30 (2004); ALASKA STAT. § 10.06.450 (2004); ARIZ. REV. STAT. ANN. § 10-830 (2004); CAL. CORP. CODE § 309 (Deering 2004); CONN. GEN. STAT. § 33-756 (2003); FLA. STAT. ANN. § 607.0830 (West 2003); GA. CODE ANN. §

14-2-830 (2004); HAW. REV. STAT. ANN. § 414-221 (LexisNexis 2003); IOWA CODE § 490.830 (2003); KY. REV. STAT. ANN. § 271B.8-300 (LexisNexis 2004); ME. REV. STAT. ANN. tit. 13-C, § 831 (2003); MD. CODE ANN., CORPS. & ASS'NS § 2-405.1 (LexisNexis 2003); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West 2004); MICH. COMP. LAWS § 450.1541A (2004); MINN. STAT. ANN. § 302A.251 (West 2003); MISS. CODE ANN. § 79-4-8.42 (2004); MONT. CODE ANN. § 35-2-441 (2004); N.H. REV. STAT. ANN. § 293-A:8.30 (2004); N.M. STAT. ANN. § 53-4-18.1 (LexisNexis 2004); N.C. GEN. STAT. § 55-8-30 (2004); N.D. CENT. CODE § 10-19.1-50 (2003); OHIO REV. CODE ANN. § 1701.59 (LexisNexis 2004); OR. REV. STAT. § 60.357 (2003); 15 PA. CONS. STAT. § 1712 (2004); R.I. GEN. LAWS § 7-1.1-33 (2004); S.C. CODE ANN. § 33-8-300 (2003); TENN. CODE ANN. § 48-18-301 (2003); VA. CODE ANN. § 13.1-690 (2004); WASH. REV. CODE ANN. § 23B.08.300 (West 2004); W. VA. CODE ANN. § 31D-8-830 (LexisNexis 2003); WYO. STAT. ANN. § 17-16-830 (2003).

n52 *See, e.g.*, Continuing Creditors' Comm. of Star Telecommc'ns Inc. v. Edgecomb, 385 F. Supp. 2d 449, 460 (D. Del. 2004) (Plaintiff must "plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence" (quoting Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002))); McMillan v. Inter-cargo Corp., 768 A.2d 492 (Del. Ch. 2000) (granting defendant's motion for judgment on the pleadings because plaintiffs failed to meet burden showing bad faith or self-dealing); *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 476 (Del. Ch. 2000) (finding that a breach of loyalty may be committed either by self-interested actions or actions of bad faith).

n53 JOEL SELIGMAN, CORPORATIONS: CASES AND MATERIALS 415 (1995).

n54 5 A.2d 503.

n55 *Id.* at 510.

n56 *Id.*

n57 *Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113 (Del. Ch. Aug. 9, 2005).

n58 *Id.* at * 163-64 (quoting *Guth*, 5 A.2d at 510).

n59 *Id.* at *164. (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

n60 Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

n61 *See, e.g.*, Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994).

n62 Stegemeier v. Magness, 728 A.2d 557, 562 (Del. 1999) ("The absolute prohibition under common law against self-dealing by a trustee has been modified in the corporate setting to offer a safe harbor for the directors of a corporation if the transaction is approved by a majority of disinterested directors."); Schock v. Nash, 732 A.2d 217, 225 n.21 (Del. 1999) ("The statute . . . provide[s] corporate directors with a safe harbor from allegations of self-dealing if the transaction is approved by a majority of the informed and disinterested directors ...."); *see also*

Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) ("[S]ection 144 [of the Delaware Code] allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule.").

n63 *Stegemeier,* 728 A.2d at 562 ("If ... the transaction is not approved by the requisite number of disinterested directors, the directors must prove that the transaction was entirely fair."); *see also Oberly,* 592 A.2d at 466-67 ("[W]here an independent committee is not available, the stockholders may either ratify the transaction or challenge its fairness in a judicial forum ... When a challenge to fairness is raised, the directors carry the burden of 'establishing . . . entire fairness.'" (citations omitted) (quoting *Weinberger,* 457 A.2d at 710)); President & Fellows of Harvard Coll. v. Glancy, No. 18790, 2003 Del. Ch. LEXIS 25, at *69 (2003) (Del. Ch. Mar. 21, 2003) ("To invoke the entire fairness standard of review, a complaint must 'allege facts as to the interest and lack of independence of the *individual members* of [the] board.'" (quoting Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002))).

n64 663 A.2d 1134 (Del. Ch. 1994).

n65 *Id.* at 1140.

n66 *Id.; see also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989) ("[B]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation." (quoting AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986))).

n67 407 A.2d 1032, 1034 (Del. 1979).

n68 *Id.* at 1035 ("In other words, the fiduciary duty exists even if the majority has a bona fide purpose for eliminating the minority; in that case, the duty of the majority is to treat the minority fairly.").

n69 No. 16415, 2004 Del Ch. LEXIS 70, at *2 (Del. Ch. June 4, 2004).

n70 *Id.*

n71 *Id.* at *35.

n72 *Id.* at *4.

N73 787 A.2d 85 (Del. 2001).

n74 *Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *35-36.

n75 *Id.* at *36.

n76 *Id.* at *43-101.

n77 *Id.* at *85.

n78 *Id.* at *81.

n79 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at * 101.

n80 *Id.* at *102.

n81 *Id.* at *103 (citing Emerald Partners v. Berlin, 787 A.2d 85, 94 (Del. 2001) (quoting Cinerama v. Technicolor, 663 A.2d 1156, 1165 & n.16 (1995))).

n82 *Id.* at * 104.

n83 *Id.*

n84 *Id.* at *116 (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)).

n85 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *137.

n86 *Id.* at *14.

n87 *Id.* at *18.

n88 *Id.* at *116-18.

n89 *Id.* at *14.

n90 *Id.* at *20.

n91 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *118-19.

n92 *Id.*

n93 *Id.* at *138 (citation omitted).

n94 *Id.* at *139.

n95 *Id.* at *140.

n96 *Emerging Commc'ns*, 2004 Del. Ch. 70, at *140.

n97 *Id.* at *140-41.

n98 *Id.* at *141.

n99 *Id.* at *140.

n100 *Id.* at *142. In its introductory sentence on Raynor's liability the court stated that "Raynor also is liable for breaching his fiduciary duty of loyalty ...." *Id.* at *140. That statement is inconsistent with the later statement that Raynor breached his "fiduciary duty of loyalty and/or good faith" and does not appear to reflect the court's analysis. *Id.* at *142.

n101 *Emerging Commc'ns*, 2004 Del. Ch. 70, at * 140-42 (footnotes omitted).

n102 *Id.* at *142 n. 184.

n103 *Id.* (citing Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004); Strassburger v. Early, 752 A.2d 557 (Del. Ch. 2000)) (emphasis omitted).

n104 *Id.*

n105 *In re* Walt Disney Co. Derivative Litig. (*Disney II*), No. 15452, 2005 Del. Ch. LEXIS 113, at *170 n.447 (Del. Ch. Aug. 9, 2005).

n106 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *146-47.

n107 *Id.* at *143.

n108 *Id.*

n109 *Id.*

n110 *Id.* at *144.

n111 *Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *147.

n112 *Id.* at *125 (footnotes omitted).

n113 *Id.*

n114 *Id.* at *147-54.

n115 *Id.*

n116 *Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *152.

n117 *Id.* (footnote omitted).

n118 *See Disney II,* No. 15452, 2005 Del. Ch. LEXIS 113, at *169, n.447 (Del. Ch. Aug. 9, 2005).

n119 *See supra* notes 52-63 and accompanying text.

n120 *See supra* notes 15-22 and accompanying text.

n121 RESTATEMENT (SECOND) OF TRUSTS, *supra* note 15, § 170(1).

n122 *Id.* § 170(2).

n123 164 N.E. 545 (1928).

n124 *Id.* at 546.

n125 *See supra* notes 102-112 and accompanying text.

n126 794 A.2d 5 (Del. Ch. 2002).

n127 *Id.* at 22 (footnotes omitted).

n128 *Id.* at 23.

n129 *Id.* (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

n130 *Id.* at 24 (citing Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993)); see also *id.* at 25 for the distinctions between "interested" and "lack of independence."

n131 *Id.* at 25.

n132 *Id.* at 26-28.

n133 *Orman,* 794 A.2d at 26.

n134 *Id.* at 28.

n135 *Id.* at 28-29.

n136 *Id.* at 30.

n137 *Id.* at 29-30.

n138 *Orman,* 794 A.2d at 29-30.

n139 *Id.* at 31.

n140 *Id.* at 31 n.70.

n141 No. 04 C 0698, 2005 WL 589000 (N.D. Ill. Mar. 11, 2005).

n142 *Id.* at *27 (citing *Orman*, 794 A.2d at 22).

n143 *Id.* at *2.

n144 *Id.* at *1.

n145 *Id.*

n146 Hollinger Int'l, Inc. v. Hollinger, Inc., No. 04 C 0698, 2005 WL 589000, at *28 (N.D. Ill. Mar. 11, 2005) (citing *Orman,* 794 A.2d at 30) (citations omitted).

n147 *Id.* at *28.

n148 *Disney II,* No. 15452, 2005 Del. Ch. LEXIS 113, at *163 (Del. Ch. Aug. 9, 2005).

n149 5 A.2d 503 (Del. 1939).

n150 *Disney II,* 2005 Del. Ch. LEXIS 113, at * 163.

n151 *Id.*

n152 Before bringing a derivative claim, the shareholder must first make a demand on the board of directors, unless a demand would be futile. *See, e.g.,* Lewis v. Curtis, 671 F.2d 779, 787 (3d Cir. 1982). A refusal of the board to pursue the claim demanded by shareholders is a decision of the board that will generally be afforded the usual protections of the business judgment rule provided it is made by disinterested directors in good faith. *See, e.g.,* Atkins v. Hibernia Corp., 182 F.3d 320, 324 (5th Cir. 1999); Cramer v. Gen. Tel. & Elec. Corp., 582 F.2d 259, 274-76 (3d Cir. 1978); Aronson v. Lewis, 473 A.2d 805, 813-17 (Del. 1984).

Shareholders are not required to make a demand on the board when that demand would be futile. These are often cases in which the action of the board of directors gave rise to the shareholder's claim. In cases where demand is excused, it is still possible for the board to terminate the litigation provided that the decision to terminate is made in good faith by disinterested directors, who apply their own business judgment. *See, e.g.,* Zapata Corp. v. Maldonado, 430 A.2d 779, 788-89 (Del. 1981).

n153 430 A.2d at 779.

n154 *Id.* at 788-89.

n155 824 A.2d 917 (Del. Ch. 2003).

n156 *Id.* at 920 (quoting Parfi Holding AB v. Mirror Image Internet, Inc., 794 A.2d 1211, 1232 (Del. Ch. 2001), *rev'd in part on other grounds,* 817 A.2d 149 (Del. 2002)).

n157 *Oracle,* 824 A.2d at 920-21.

n158 *Id.* at 920.

n159 *Id.*

n160 *Id.* at 920-21.

n161 *Id.* at 921.

n162 *Oracle*, 824 A.2d at 928.

n163 *Id.* at 948.

n164 *Id.* at 942.

n165 No. 19988-NC, 2004 Del. Ch. LEXIS 4 (Del. Ch. Feb. 11, 2004).

n166 *Id.* at *11.

n167 *Id.*

n168 *Id.* at *10.

n169 *Id.* at *8-9.

n170 *Disney II*, No. 15452, 2005 Del. Ch. LEXIS 113, at *163-64 (Del. Ch. Aug. 9, 2005) (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)).

n171 *Id.* at *169.

n172 *Id.* at *169 n.447.

n173 *Id.* at *177.

n174 *Id.* at *173.

n175 *See New EBRI Research: Defined Contribution Worker Coverage Grows; Retirement Savers Continue Reliance on Stocks*, U.S. NEWSWIRE, Jan. 21, 2004 ("The segment relying solely on defined contribution retirement plans, such as 401(k)s, rose from 40.8% to 61.5% in the 1992-2001 period . . . ."). Defined contribution plans held more than $ 3.9 trillion in 2003. *Total Assets Increase in Retirement Plans,* WALL ST. J., Apr. 26, 2004, at C3.

n176 Muir, *supra* note 15, at 393 n.19. Depending upon the plan's vesting provisions, some of the assets may be forfeitable for some period of time.

n177 A KSOP is a hybrid plan with both ESOP and 401(k) components;. *See* Janice Kay Lawrence, *Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(k) Plan Participants*, 92 KY. L.J. 1, 25 (2003-2004). This hybrid structure translates into millions of dollars in tax savings for large publicly traded companies and serves as a strong incentive for 401(k) conversion into KSOPs. *See id.* (citing Ellen E. Schultz & Theo Francis, *Companies' Hot Tax Break: 401(k)s,* WALL ST. J., Jan 31, 2002, at C1).

n178 Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 8-9 (2002).

n179 *See* Dana M. Muir & Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?*, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 279, 282 (2004-2005) (discussing the authors' reasons for adopting this terminology).

n180 Lawrence, *supra* note 177, at 4 n.8. Employers have begun to reevaluate the use of company stock in these plans. *See, e.g.,* Suzanne Cosgrove, *An Unhealthy Slice of Company Stock,* CHI. TRIB., Mar. 26, 2006, at C5.

n181 Maureen B. Cavanaugh, *Tax as Gatekeeper: Why Company Stock is Not Worth the Money*, 23 VA. TAX. REV. 365, 378-79 (2003).

n182 *See, e.g., In re* Worldcom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 751-54 (S.D.N.Y. 2003).

n183 *Id.*

n184 *See, e.g.,* DiFelice v. US Airways, Inc., 397 F. Supp. 2d 758 (E.D. Va. 2005); *Worldcom,* 263 F. Supp. 2d 745.

n185 *See, e.g.,* Pa. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654 (E.D. Pa. Oct. 12, 2004); Enron Corp. Sec., Derivative, & "ERISA" Litig., 284 F. Supp. 2d 511 (S.D. Tex. 2003).

n186 *See, e.g.,* Howell v. Motorola, 337 F. Supp. 2d 1079 (N.D. Ill. 2004); Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003).

n187 Muir & Schipani, *supra* note 179, at 331-40.

n188 The two primary categorizations of pension plans are as defined benefit or defined contribution plans. *See* Muir, *supra* note 178, at 5.

n189 *See generally* JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY 118 (2004). During the 1960s, the Senate Permanent Subcommittee on Investigations discovered the trustee of two union pension and welfare funds had arranged for several million dollars in plan funds to be moved to companies in Puerto Rico and Liberia. According to federal officials, no federal laws precluded the trustee's actions. Similarly, Jimmy Hoffa, former head of the Teamsters Union, was prosecuted for conspiracy and mail and wire fraud for the self-interested loans he received from a union pension fund. There was no pension-specific federal law that governed Hoffa's behavior. *Id.*

n190 ERISA § 403, 29 U.S.C. § 1103 (2000).

n191 *Id.* § 404(a)(1)(A)(i); *see also* EMPLOYEE BENEFITS LAW 662 (Steven J. Sacher et al. eds., 2d ed. 2000); Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule,* 55 U. CHI. L. REV. 1105, 1108 (1988) ("ERISA's exclusive benefit rule . . . imports into pension fiduciary law one of the most fundamental and distinctive principles of trust law, the duty of loyalty."). In addition to the fiduciary obligation of loyalty, ERISA requires fiduciaries to act prudently; to diversify investments; and to act in accordance with the benefit plan's terms to the extent those terms do not conflict with ERISA. ERISA § 404(a)(1)(B)-(D).

n192 ERISA § 408(c)(3). ERISA defines a party in interest to include plan service providers, an employer with employees who are plan participants, certain individuals and entities with an ownership interest in a plan sponsor, and plan fiduciaries. *Id.* § 3(14).

n193 Fischel & Langbein, *supra* note 191, at 1126-28.

n194 These provisions are broadly drawn to proscribe any transactions between a party in interest, including a fiduciary, and the plan. § 406. The Department of Labor has issued numerous class and individual exemptions to the prohibited transactions provisions. For a detailed discussion of those exemptions, see Donald J. Myers & Michael B. Richman, *Class Exemptions from Prohibited Transactions, in* ERISA FIDUCIARY LAW 267 (Susan P. Serota ed., 1995); William P. Wade & Richard I. Loebl, *Individual Prohibited Transaction Exemptions, in* ERISA FIDUCIARY LAW 315 (Susan P. Serota ed., 1995); EMPLOYEE BENEFITS LAW, *supra* note 191, at 744-63. One specific exception permits benefit plans to acquire employer securities for adequate consideration. § 408(e). Plaintiffs in company stock cases have unsuccessfully alleged that the use of company stock in the plan when the stock is an imprudent investment constitutes a breach of the prohibited transaction requirements because the stock is purchased for more than adequate consideration. *See, e.g., In re* Honeywell Int'l ERISA Litig., No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *46-49 (D.N.J. Sept. 14, 2004).

n195 *See, e.g.,* Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).

n196 Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928); *see supra* text accompanying notes 1-2.

n197 Hughes Aircraft Co. v. Jacobson, 525 U.S. 432. 445 (1999) (quoting Lockheed Corp. v. Spink. 517 U.S. 882, 893 (1996)).

n198 *See, e.g.*, Daniel Halperin, *Employer-Based Retirement Income--The Ideal, the Possible, and the Reality,* 11 ELDER L.J. 37, 56 ("Moreover, one of the motivations for establishing pension plans is to reduce turnover and retain skilled workers.").

n199 Dana M. Muir, *ERISA Remedies: Chimera or Congressional Compromise?*, 81 IOWA L. REV. 1, 15 (1995).

n200 ERISA § 402(a), 18 U.S.C. § 1102(a) (2000).

n201 ERISA § 3(21)(A). Typically, individuals become functional fiduciaries by having discretion over the assets, administration, or management of a benefit plan or by providing investment advice for a fee to a plan. *Id.*

n202 *Id.*

n203 *In re Elec. Data Sys. Corp. "ERISA" Litig.*, 305 F. Supp. 2d 658, 666-67 (E.D. Tex. 2004); *see also In re* Tyco Int'l, No. 02-1335-PB, 2004 U.S. Dist. LEXIS 24272, at *16 (D.N.H. Dec. 2, 2004) (categorizing board members as fiduciaries due to power to appoint fiduciaries).

n204 *See, e.g.*, LaLonde v. Textron, Inc., 369 F.3d 1 (1st Cir. 2004) (reversing dismissal); *In re* Xcel Energy, Inc., 364 F. Supp. 2d 980 (D. Minn. 2005) (awarding attorneys fees); *In re* Xcel Energy, Inc., 364 F. Supp. 2d 1005 (D. Minn. 2005) (approving settlement); *In re* Polaroid ERISA Litig., 362 F. Supp. 2d 461 (S.D.N.Y. 2005) (denying motion to dismiss).

n205 Jessica Marquez, *Taking Stock*, WORKFORCE MGMT., May 2005, at 79, *available at* http://www.workforce.com/section/02/feature/24/03/71/index.html.

n206 263 F. Supp. 2d 745, 763 (S.D.N.Y. 2003); *see also* 59 Fed. R. Serv. 3d 1170 (S.D.N.Y. 2004) (approving partial settlement).

n207 397 F. Supp. 2d 758, 771-72 (E.D. Va. 2005).

n208 *Id.* at 773.

n209 *Id.* at 773-74.

n210 *See infra* notes 213-230 and accompanying text.

n211 *See infra* notes 213-220 and accompanying text.

n212 *See infra* notes 221-230 and accompanying text.

n213 362 F. Supp. 2d 461, 479 (S.D.N.Y. 2005).

n214 263 F. Supp. 2d 745, 768 (S.D.N.Y. 2003).

n215 *Id.* at 767.

n216 *Id.* at 768.

n217 *Id.*

n218 No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715, at *9 (S.D.N.Y. Mar. 10, 2005).

n219 *Id.* at *25.

n220 *Id.*

n221 No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *44-45 (D.N.J. Sept. 14, 2004). It does not appear that these particular claims were alleged against company directors, but the plaintiffs' theory would seem to apply to directors who receive stock-based compensation.

n222 *Id.* at *45.

n223 *Id.*

n224 *Id.* at *27-34.

n225 *Id.* at *35-40.

n226 *In re* Honeywell Int'l ERISA Litig., 2004 U.S. Dist. LEXIS 21585, at *44-45.

n227 313 F. Supp. 2d 1361, 1370 (N.D. Ga. 2004).

n228 *Id.*

n229 *Id.* at 1369-70.

n230 *Id.* at 1370.

n231 *See supra* text accompanying note 192.

n232 Mertens v. Hewitt Assocs., 508 U.S. 248, 251-52 (1993).

n233 309 F. Supp. 2d 861, 896 (S.D. Tex. 2004).

n234 *Id.* at 897 (quoting Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 299 (5th Cir. 2000)).

n235 309 F. Supp. 2d at 897-98.

n236 No. 02-9049, 2004 U.S. Dist. LEXIS 20654, at *6 (E.D. Pa. Oct. 12, 2004).

n237 *Id.*

n238 305 F. Supp. 2d 658, 673 (E.D. Tex. 2004).

n239 *Id.*

n240 *Id.*

n241 *Id.*

n242 *See, e.g.*, Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 444 (1999).

n243 *Id.* at 146-47.

n244 *See infra* notes 298-304 and accompanying text.

n245 *Id.*

n246 No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *39 (D.N.J. Sept. 14, 2004).

n247 *See* Muir & Schipani, *supra* note 179, at 356-57.

n248 *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 552 (S.D. Tex. 2003) ("A person or entity that has the power to appoint, retain and/or remove a plan fiduciary from his position has discretionary authority or control over the management or administration of a plan and is a fiduciary to the extent that he or it exercises that power."); *see also* Questions and Answers Relating to Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.75-8, FR-17 (2006) ("At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary ... to ensure that their performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan.").

n249 *See, e.g., In re* Sprint Corp. ERISA Litig., No. 03-2202-JWL, 2004 WL 2182186, at *2 (D. Kan. Sept. 24, 2004).

n250 *See, e.g., In re* Cardinal Health, Inc. Erisa Litig., No. C2-04-643, 2006 WL 833129, at *31-32 (S.D. Ohio Mar. 31, 2006).

n251 337 F. Supp. 2d 1079 (N.D. Ill. 2004).

n252 *Id.* at 1096 (citation of record omitted). In *In re AOL Time Warner, Inc. Securities and "ERISA" Litigation,* a similar claim, alleging that defendant board members breached their fiduciary duties by appointing company employees who lacked independence as fiduciaries, survived a motion to dismiss. No. 02 Civ. 8853, 2005 U.S. Dist LEXIS 3715, at *24 (S.D.N.Y. Mar. 10, 2005).

n253 *Howell,* 337 F. Supp. 2d at 1097.

n254 *Id.*

n255 *Id.*

n256 *Id.* (citation to record omitted).

n257 *Id.* The plaintiffs in *In re WorldCom, Inc. ERISA Litigation* argued that the company directors were fiduciaries because they acted on behalf of WorldCom, which had been named by the plan as its Plan Administrator and Investment Fiduciary, and thus they had fiduciary obligation to appoint and monitor plan fiduciaries. *See In re* Worldcom, 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003), *aff'd*, No. 02 Civ.4816(DLC), 2004 LEXIS 20, 671 (S.D.N.Y. Oct. 18, 2004) (approving partial settlement). The plaintiffs attempted to reinforce their argument by relying on the law of Georgia, where WorldCom was incorporated, which provides, as do most state corporation statutes, that boards of directors have the responsibility to oversee the corporation's business and management. *See WorldCom,* 263 F. Supp. 2d at 760. The court concluded that the plaintiffs' argument proved too much because its logical result would be that every person who supervised an ERISA fiduciary automatically would become an ERISA fiduciary. *See id.* Nor, according to the court, did the argument appropriately recognize the difference between board members' obligations as plan settlors, which do not result in any fiduciary duty, and their obligations as plan fiduciaries. *Id.* at 761.

n258 *See* Howell v. Motorola, 337 F. Supp. 2d 1079, 1097-99 (N.D. Ill. 2004).

n259 Edward E. Bintz, *Fiduciary Responsibility Under ERISA: Is There Ever a Fiduciary Duty to Disclose?,* 54 U. PITT. L. REV. 979, 980 (1993).

n260 Varity Corp. v. Howe, 516 U.S. 489, 506 (1996).

n261 *See generally* Bryan L. Clobes, *In the Wake of* Varity Corp. v. Howe: *An Affirmative Fiduciary Duty to Disclose Under ERISA*, 9 DEPAUL Bus. L.J. 221, 226-27 (1997) ("The recent trend favors imposing upon fiduciaries the common law rule requiring; them to disclose material information concerning existing plans and benefits when they know that silence might be harmful."); Joseph E. Czerniawski, Comment, Bins v. Exxon: *Affirmative Duties to Disclose Proposed Benefit Changes in the Absence of Employee Inquiry*, 76 NOTRE DAME L. REV. 783, 808 (2001) ("There has been considerable disagreement among the lower courts dealing with disclosure of proposed benefit changes, but there has been a trend towards a 'serious consideration' test as triggering fiduciary disclosure duties in these cases."); Melissa Elaine Stover, Note, *Maintaining ERISA's Balance: The Fundamental Business Decision v. The Affirmative Fiduciary Duty to Disclose Proposed Changes*, 58 WASH. & LEE L. REV. 689, 691 (2001) ("The current trend in the federal courts [is] to expand a plan administrator's disclosure duties by emphasizing her fiduciary obligation to provide material information to plan participants."). The Supreme Court, however, has left open the question of whether fiduciaries must make disclosures in the absence of a specific statutory or regulatory obligation and a direct question from a participant. In the context of potential transactions in plan stock, disclosure also raises securities law issues including insider trading. *See* Muir & Schipani, *supra* note 179, at 287-89.

n262 Clobes, *supra* note 261, at 227.

n263 *See, e.g.*, Shea v. Esensten, 107 F.3d 625, 628 (8th Cir. 1996); *see also* Bins v. Exxon Co. U.S.A., 220 F.3d 1042, 1049 (9th Cir. 2000) (requiring accurate responses to questions when plan amendments are under serious consideration).

n264 *See* DiFelice v. US Airways, Inc., 397 F. Supp. 2d 758, 769-72 (E.D. Va. 2005) (dismissing claims of failure to disclose because plan had met all specific ERISA requirements); Pa. Fed'n v. Norfolk S. Corp., No. 02-9049, 2004 U.S. Dist. LEXIS 20654, at *8 (E.D. Pa. Oct. 12, 2004) (arguing the duty to disclose derives from the duty of prudence).

n265 *See In re* Elec. Data Sys. Corp. "ERISA" Litig., 305 F. Supp 2d 658, 673 (E.D. Tex. 2004).

n266 *Id.*

n267 *Id.*

n268 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11 U.S.C.A., 15 U.S.C.A., 18 U.S.C.A., and 28 U.S.C.A. (2002)).

n269 *See, e.g.*, David A. Katz & Laura A. McIntosh, *Director Compensation Moves Up Board Agendas*, 235 N.Y. L.J. 5 (2006) ("It is undeniable that more is being expected of directors today in terms of ... exposure to public scrutiny and potential liability.").

n270 *See, e.g.*, Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 53-68 (2005); Sale, *supra* note 103, at 456-62.

n271 *See supra* Part III.C.

n272 *See supra* Parts I & III.B.

n273 *See supra* Parts II.B.2 & III.B.

n274 *See supra* notes 64-68 and accompanying text.

n275 488 A.2d 858 (Del. 1985); *see also, e.g.,* R. Franklin Balotti & Mark J. Gentile, *Commentary from the Bar, Elimination or Limitation of Director Liability for Delaware Corporations,* 12 DEL. J. CORP. L. 5, 9 (1997); Dennis J. Block et al., *Advising Directors on the D&O Insurance Crisis,* 14 SEC. REG. L.J. 130, 131-32 (1986); Karen L. Chapman, *Statutory Responses to Boardroom Fears,* 3 COLUM. Bus. L. REV. 749, 749-50 (1987).

n276 *See* DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 12-18 (5th ed. 1998).

n277 *See supra* Parts III.B & III.C.

n278 *See supra* Part II.B.

n279 *See, e.g.,* Growbow v. Perot, 539 A.2d 180, 188 (Del. 1988) (finding allegation that directors received payment for their services insufficient to establish financial interest); Orman v. Cullman, 794 A.2d 5, 28-29 (Del. Ch. 2002) (finding board service insufficient to cause directors to be interested, at least as long as director received only normal fees); Moran v. Household Int'l, Inc., 490 A.2d 1059, 1075 (Del. Ch. 1985) ("[I]t is ... obvious that if directors were held to the same standard as ordinary fiduciaries the corporation could not conduct business." (quoting Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980))); *see also In re* eBay S'holders Litig., No. 19988-N.C., 2004 Del. Ch. LEXIS 4, at *10-11 (Del. Ch. Feb. 11, 2004) (indicating concern that directors were beholden to other directors for the board positions but also finding that millions of dollars of unvested options affected their lack of independence).

n280 *See supra* notes 192-193 and accompanying text.

n281 *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *142 n.184 (Del. Ch. June 4, 2004).

n282 *Id.* at *111.

n283 *Id.* at *142 n.184.

n284 *Id.*

n285 *Id.* at *142. The court is not clear in this portion of the opinion about the extent of Raynor's economic interests and dependence on Prosser. Earlier, though, it had discussed those interests in detail. *See supra* text accompanying notes 96-105.

n286 *Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *142.

n287 *Id.* at *142 n.184.

n288 *Id.* at *142.

n289 *Id.* at *142 n. 184.

n290 *Id.* at *137.

n291 *See supra* text accompanying notes 18-19.

n292 *See supra* Part III.C.1.

n293 *See supra* notes 242-245 and accompanying text.

n294 *Id.*

n295 *See* Muir & Schipani, *supra* note 179, at 321-24.

n296 *Id.*

n297 *Id.* at 321 (describing settlor doctrine as meaning that actions taken to establish, amend, or terminate an employee benefit plan are not fiduciary actions and do no not create fiduciary duties).

n298 62 F.3d 553 (3d Cir. 1995).

N299 *Id.* at 571 (quoting RESTATEMENT (SECOND) OF TRUSTS § 227 cmt. g (1959)).

n300 *See, e.g.,* Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1098 (9th Cir. 2004); *In re* SYNCOR ERISA Litig., 351 F. Supp. 2d 970 (C.D. Cal. 2004).

n301 ERISA § 407(d)(6)(A), 29 U.S.C. § 1107(d)(6) (2000).

n302 *See, e.g.*, Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758, at *20-23 (W.D.N.Y. Jan. 14, 2004); *In re* WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 764-65 (S.D.N.Y. 2003).

n303 *See* Moench v. Robertson, 62 F.3d 553, 560-61 (3d Cir. 1995). In the ESOP context, this duty is often referred to as the "duty of prudence." The statute requires fiduciaries to act "with the care, skill, prudence, and diligence under the circumstances ...." ERISA § 404(a)(1)(B).

n304 *Compare In re* Reliant Energy ERISA Litig., 366 F. Supp. 2d 646, 668-69 (S.D. Tex. 2004) (holding the presumption should not be applied at motion to dismiss), *In re* Xcel Energy, Inc. Sec., Derivative & "ERISA" Litig., 312 F. Supp 2d 1165, 1180 (D. Minn. 2004) (same), *In re* CMS Energy ERISA Litig., 312 F. Supp. 2d 898, 914 (E.D. Mich. 2004) (same), *and In re* EDS Corp. "ERISA" Litig., and 305 F. Supp. 2d 658, 668-70 (E.D. Tex. 2004) (same), *with In re* Sprint Corp. ERISA Litig., 388 F. Supp. 2d 1207 (D. Kan. 2004) (holding allegations were insufficient to rebut the presumption).

n305 No. 02 Civ. 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. Mar. 10, 2005).

n306 *Id.* at *25.

n307 *Id.*

n308 *See supra* text accompanying notes 210-247.

n309 *See supra* text accompanying notes 96-105.

n310 *See* Sale, *supra* note 103, at 483.

n311 *See* Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002); Hollinger Int'l, Inc. v. Hollinger Inc., No. 04 C 0698, 2005 WL 589000, at *28 (N.D. Ill. Mar. 11, 2005); see also *supra* text accompanying notes 126-147 for a detailed discussion of these cases.

n312 *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 920 (Del. Ch. 2003) (emphasis omitted) (citations omitted).

n313 *See* ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (2000); *see also supra* notes 192-194 and accompanying text.

n314 *See* Mertens v. Hewitt Assocs., 508 U.S. 248, 251-52 (1993).

n315 *See* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 115 (1989); *see also supra* notes 232-247 and accompanying text.

n316 *See, e.g.*, Orman v. Cullman, 794 A.2d 5, 22 (Del. Ch. 2002); *see also* Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. Civ.A. 20228-NC, WL 1949290, at *10-11 (Del. Ch. Aug. 24, 2004) (applying *Orman* standards).

n317 *See* Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995).

n318 *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *35-36 (Del. Ch. June 4, 2004); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1140 (Del. Ch. 1994); *see also supra* notes 63-68 and accompanying text.

n319 *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

n320 *See Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *38.

n321 *Id.* at *101.

n322 *Id.* at *112-13.

n323 *Id.* at *112-13.

n324 *Emerging Commc'ns,* 2004 Del. Ch. LEXIS 70, at *116-37.

n325 *Id.* at *116-38.

n326 *Id.* at *119-20.

n327 *Id.*

n328 EMPLOYEE BENEFITS LAW, *supra* note 191, at 662.

n329 *See* Donovan v. Bierwirth, 680 F.2d 263, 264-68 (2d Cir. 1982).

n330 *Id.* at 268-69.

n331 *Id.* at 271.

n332 *Id.* at 272 n.9.

n333 *Id.* at 271-72.

n334 *Donovan*, 680 F.2d 263 at 272-73.

n335 *Id.* at 273.

n336 *Id.* at 274.

n337 No. C-79-495-WHO, 1980 U.S. Dist. LEXIS 17767 (N.D. Cal. Apr. 18, 1980).

n338 *Id.* at *15-16.

n339 *Id.* at *18.

n340 *Id.* at *21-22; *see also* Reich v. Lancaster, 55 F.3d 1034, 1058 (5th Cir. 1995) (finding fiduciary breached duty of loyalty by causing health and welfare fund to purchase coverage at unreasonable costs with result that fiduciaries received excessive commissions).

n341 *See, e.g.*, *In re* Winstar Energy, Inc., No. 03-4031, 2005 U.S. Dist. LEXIS 28585, at *81-82 (D. Kan. Sept. 29, 2005) (evaluating compensation-based conflicts of interest); *In re* Honeywell Int'l ERISA Litig., No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *44-45 (D.N.J. Sept. 14, 2004) (allowing loyalty claim based on alleged compensation conficts); Hill v. Bellsouth Corp., 313 F. Supp. 2d 1361, 1370 (N.D. Ga. 2004) (allowing loyalty claim based on fiduciaries' alleged inside information and selling of own securities); *see also* Whitman v. IKON, No. 1318, 2002 U.S. Dist. LEXIS 14683, at *12-13 (E.D. Pa. Aug. 9, 2002) (approving settlement of loyalty claims based on fiduciaries' insider status and appointing independent advisors to serve on plan committee).

n342 We realize this factor implicates insider trading issues under the federal securities laws and, thus, might require broader dissemination of the relevant information. *See* Muir & Schipani, *supra* note 179, at 283-90.

n343 *See supra* Part III.C.3.

n344 *See supra* notes 192-193 and accompanying text.

n345 *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (defining business judgment rule); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994) (describing entire fairness review).

n346 *See, e.g.*, I.R.C. § 402, 404(a) (2000) (providing immediate deduction for employers' contribution); *see also* Muir & Schipani, *supra* note 179, at 353-54.

n347 *In re* Emerging Commc'ns, Inc. S'holder Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *140 (Del. Ch. May 3, 2004).

n348 *Id.* at *142 n.184, *146-47.

n349 *Id.* at *142 n.184.

n350 *See supra* Part II.B.

n351 *See, e.g.*, Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002).

n352 No. 15452, 2005 Del. Ch. LEXIS 113 (Del. Ch. Aug. 9, 2005).

n353 No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. June 4, 2004).

n354 284 F. Supp. 2d 511 (S.D. Tex. 2003).

n355 397 F. Supp. 2d 758 (E.D. Va. 2005).

n356 *See Disney II*, 2005 Del. Ch. LEXIS 113, at *164.

n357 *Id.* (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983)).

n358 *See Emerging Commc'ns*, 2004 Del. Ch. LEXIS 70, at *140-42.

n359 362 F. Supp. 2d 461 (S.D.N.Y. 2005).

n360 263 F. Supp. 2d 745 (S.D.N.Y. 2003).

n361 No. 02 Civ 8853, 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y. Mar. 10, 2005).