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Abstract

Business history and theory reflect a tension between public and private conceptions of the corporation. This tension and conceptual ambiguity lay close to the surface of The Modern Corporation and Private Property, in which Berle and Means portrayed the modern public corporation as straddling the public/private divide. It is also embodied in the famous Berle-Dodd debate, which provides the basis for contemporary clashes between “different visions of corporatism,” such as the conflict between shareholder primacy and stakeholder-centered versions of the corporation.

This chapter examines a number of recent developments suggesting that the pendulum, which swung so clearly in favour of a private conception of the corporation from the 1980s onwards, is in the process of changing direction. The chapter provides two central insights. The first is that there is not one problem, but multiple problems in corporate law, and that different problems may come to the forefront at different times. Although financial performance is a legitimate concern in corporate law, it is also important to recognize, and address, the danger that corporate conduct may result in negative externalities and harm to society.

The chapter argues that it is therefore, a mistake to view the two sides of the Berle-Dodd debate as binary and irreconcilable. The second insight is that corporate governance techniques (such as performance-based pay), which are designed to ameliorate one problem in corporate law, such as corporate performance, can at the same time exacerbate other problems involving the social impact of corporations.

As the chapter shows, a number of recent developments in corporate law have highlighted the negative externalities and social harm that corporate actions can cause. These developments suggest the emergence of a more cohesive vision of the corporation that encompasses both private and public aspects. The developments also potentially affect the role and duties of company directors, who are no longer seen merely as monitors of corporate performance, but also as monitors of corporate integrity and the risk of social harm.

Keywords: Corporate theory, business history, Berle-Dodd debate, shareholders, stakeholders, corporate culture, directors’ duties and liability.

JEL Classifications: D70, G30, G34, G38, K10, K19, K22, K39, N4, N20, N80, M14

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Corporations, Directors’ Duties and the Public/Private Divide

Jennifer G. Hill*


1. Introduction

In their classic 1932 text, The Modern Corporation and Private Property, 1 Berle and Means viewed the public corporation as a profoundly ambiguous entity, straddling the divide between public and private law. This public-private divide created ongoing tension in corporate law history and practice. 2

A decidedly private conception emerged in the 1980s, in the form of the law and economics “nexus of contracts” theory of the corporation. 3 Under this theory, which subsequently became

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3 The “nexus of contracts” economic theory represents a private aggregational concept of the corporation, which is viewed merely as a “complex set of explicit and implicit contracts”. Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 COLUM. L. REV. 1416, 1418 (1989). See also William W. Bratton Jr., The “Nexus of Contracts” Corporation: A Critical Appraisal, 74 CORNELL L. REV. 407, 417-20 (1989). Given that non-shareholder stakeholder contracts are included in the contractual nexus, there is nothing per se about this theory that compels a shareholder-centered view of the corporation. Nonetheless, under the classical economic “nexus of contracts” theory of the corporation, shareholder interests are treated as preeminent. See, e.g., David Millon, Theories of the Corporation, 1990 DUKE L.J. 201, 229-31; Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23 (1991). This theory also treats shareholders as principals and corporate managers as their agents. See Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. FIN. ECON. 305, 308-09 (1976). However, similar aggregational theories have been used by some scholars to subvert any presumption of shareholder primacy. See, e.g., Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. REV. 247, 253-54 (1999)
the dominant corporate law paradigm in the United States and a number of other jurisdictions,\(^4\) shareholder interests and corporate performance took center stage. In recent times, however, the pendulum has swung in the opposite direction and there has been far greater attention to stakeholder interests and the social responsibilities of corporations and their directors and officers.

According to the Greek poet, Archilochus, “[t]he fox knows many things, but the hedgehog knows one big thing.”\(^5\) The law and economics theory of the corporation embodies the latter approach, representing a “a single, universal, organising principle,”\(^6\) whereby the key agency problem of corporate law is misalignment of the interests of company directors and officers with the interests of shareholders.\(^7\)

However, recent financial scandals, such as the Wells Fargo fraudulent accounts scandal in the United States and scandals at some of Australia’s leading banks,\(^8\) have emphasized the fact that there is not one, but rather multiple problems in corporate law. These scandals highlighted two distinct problems in corporate law. The first is a legitimate concern about corporate financial performance.\(^9\) This is a particularly important issue, given that we now live in an age

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\(^6\) *Id.*

\(^7\) Some scholars in the field of financial economics view corporate governance more broadly as applying to “suppliers of finance” to the corporation, which includes creditors as well as shareholders. See Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 737 (1997). Nonetheless, Shleifer and Vishny acknowledge that “[o]ur perspective on corporate governance is a straightforward agency perspective, sometimes referred to as separation of ownership and control. We want to know how investors get managers to give them back their money.” *Id.*, 738.

\(^8\) See *infra*, text accompanying fns 57-72.

of “forced capitalism”\textsuperscript{10} where, in a number of jurisdictions, members of the public have become involuntary investors in the stock market via mandatory retirement saving schemes.\textsuperscript{11} The second problem is the danger that corporate conduct may result in negative externalities and harm to society.\textsuperscript{12} These scandals demonstrated in an acute way that enhanced financial performance can have a dark side in terms of harm to stakeholders or society as a whole. They also showed that corporate governance techniques designed to address the first problem may exacerbate the second, by creating perverse incentives for corporate misconduct.\textsuperscript{13} One of the consequences of an increasing focus on this second problem of corporate law is greater regulatory attention to the issue of corporate culture.\textsuperscript{14} This is closely tied to a more public conception of the corporation,\textsuperscript{15} and renewed attention to the need to ensure responsibility and accountability for corporate actions.\textsuperscript{16}


\textsuperscript{11} According to Chancellor Strine, most US employees in the private sector with 401(k) retirement plans “have little choice but to invest in the market.” \textit{Id}. The position in Australia is similar, given its distinctive system of retirement (“superannuation”) funding. See, e.g., \textit{SUPER SYSTEM REVIEW FINAL REPORT, PART ONE, OVERVIEW AND RECOMMENDATIONS}, Appendix B, 69 (2010) (“Cooper Review”). Cf Lynn A. Stout, \textit{The Mythical Benefits of Shareholder Control}, 93 VA. L. REV. 789, 801 (2007) (adopting a traditional “voluntary investment” paradigm, stating “investors are not forced to purchase shares in public corporations at gunpoint”).

\textsuperscript{12} See, e.g., Richard M. Buxbaum, \textit{Corporate Legitimacy, Economic Theory, and Legal Doctrine}, 45 OHIO ST. L.J. 515, 517-18 (1984) (supporting the view that the external effects of corporate action in the public domain cannot be ignored). See also Langevoort, \textit{supra} note 9 (discussing the concept of “publicness” as a form of legitimacy and “social licence”).

\textsuperscript{13} See Jennifer G. Hill, \textit{Deconstructing Sunbeam – Contemporary Issues in Corporate Governance}, 67 U. CIN. L. REV. 1099, 1120-25 (1999) (discussing the Sunbeam scandal, which was arguably an early example of the risk posed by perverse incentives).


This chapter argues that there are multiple problems in corporate law, and that different problems may come to the forefront at different times, creating a tension between public and private conceptions of the corporation. The chapter also explores the implications of this tension for the duties and accountability of company directors and officers. The chapter proceeds as follows. Part 2 provides a snapshot of the history and theory of corporations from a public-private perspective. Part 3 discusses the implications of the public-private tension for directors’ fiduciary duties and examines the divergent approaches taken in the famous Berle-Dodd debate. Part 4 considers some recent developments concerning corporate culture and societal harm, against the backdrop of the recent US and Australian banking scandals. Part 5 explores, from a comparative law perspective, the issue of directors’ liability for flawed corporate cultures that result in negative externalities or breach of the law, and Part 6 concludes.

2. Corporate Law History, Legal Theory and the Public/Private Divide

The tension between public and private conceptions of corporate law has a long history. The corporation, as a result of its group characteristics, traditionally occupied an ambiguous and intermediate position within liberal theory’s dichotomy between state and individual. From one perspective, corporations could appear to be creations of the state, justifying clear limitations on their powers as a result of their public status. Through a different lens, however, they could be viewed as private organizations, protecting the rights of individuals from state incursion.

US corporations had strong quasi-public roots. They were derived from early UK royal chartered corporations, which were effectively viewed as arms of the state. Most US

17 This chapter focuses on historical developments in this regard in common law jurisdictions only. For discussion of historical developments regarding public interest corporations in a civil law jurisdiction, Japan, see Masayuki Tamarya, “The Reform of the Japanese Law of Non-Profits: A Historical and Comparative Perspective,” ch __ (this volume).


20 As such, royal chartered corporations were required to fulfil societal purposes. See generally Jennifer G. Hill, The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering Combat, 2019 U. ILL. L. REV. 507, 541-44; Gower, supra note 19, 1370-72; LAWRENCE M.
chartered corporations prior to the American Revolution were in fact “bodies politic,” such as towns, districts, and religious and educational institutions, and it was not until the late 18th century that chartered “for profit” business corporations became ascendant. Yet, American corporate law during this period did not distinguish between business corporations and bodies politic. All chartered corporations were regarded as “public agencies,” and, as such, heavily restricted in their activities and required to serve a societal purpose.

During the 19th century, however, the corporation attempted to dissociate itself from the state and fought to secure rights and freedom of association. This led to the emergence of a private contractual conception of the corporation (a forerunner to the law and economics theory) by

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the close of the century, swiftly followed by the rise of state competition for incorporation charters. These developments supported a new image of US state corporate law as “enabling.” They also created the modern US bifurcation between private and public law - whereby business corporations came to be classified as private organizations, attracting legal protection under modern “enabling” legislation, while municipal corporations continued to be treated as public entities, requiring strong public law constraint.

This tension and conceptual ambiguity lay close to the surface of The Modern Corporation and Private Property, in which Berle and Means portrayed the modern public corporation as straddling the public/private divide. The authors described the public corporation as a kind of “economic empire,” while at the same time, highlighting its “quasi-public” characteristics. In view of these chameleon-like qualities, Berle and Means considered that corporate law of the future could develop into either a species of private law or of public law.

3. The Public/Private Divide, Directors’ Duties and the Berle-Dodd Debate

This public-private tension has implications for directors’ fiduciary duties, as was shown in the famous Berle-Dodd debate. In 1932, Professors Berle and Dodd engaged in an intense...
debate concerning the nature of directors’ responsibilities.35 Although both men agreed that directors were “trustees,”36 and as such owed fiduciary duties, they vehemently disagreed as to whom those duties were owed.37 Berle adopted a private aggregate theory of the corporation, which supported his claim that directors held their powers in trust for shareholders as beneficiaries.38 Dodd, on the other hand, regarded the corporation as a public institution, and argued that directors owed their duties to a diverse group of stakeholders, including employees, creditors, and consumers.39 Berle, a pragmatist, considered that Dodd’s model failed to represent any effective constraint on managerial power.40

The Berle-Dodd debate has been said to represent a “clash between the different visions of corporatism.”41 Furthermore, those visions have been regarded as binary and irreconcilable. For example, the Berle-Dodd debate laid the groundwork for the ongoing dispute concerning shareholder primacy versus stakeholder primacy.42 Yet, the divide between Berle and Dodd was perhaps less clear-cut than often thought, because both men later appeared to swap positions, acknowledging that the other had won the debate.43

35 See Adolf A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932); Adolf A. Berle, Jr., For Whom Corporate Managers Are Trustees: A Note, 45 HARV. L. REV. 1365 (1932).
36 Although company directors are no longer regarded as trustees, trust law continues to play an important role in other areas of fiduciary law. See, e.g., Arthur B. Laby, “Trust, Discretion and ERISA Fiduciary Status,” ch. __ (this volume).
37 See generally Jennifer G. Hill, Then and Now: Professor Berle and the Unpredictable Shareholder, 33 SEATTLE U. L. REV. 1005, 1009-10 (2010).
38 See Berle, supra note 35 (1931); Berle, supra note 35 (1932).
39 See Dodd, supra note 35.
40 See Berle, supra note 35 (1932).
By the 1980s, however, Professor Berle’s original idea of corporatism appeared to prevail in the form of the law and economics “nexus of contracts” theory. But, even Milton Friedman, the quintessential proponent of a private model of the corporation, acknowledged that corporate law operates within a public matrix of laws and norms. Friedman famously declared that “[t]here is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits.” Nonetheless, he followed that edict with the less familiar coda – “so long as it [i.e. business] stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”

A number of recent international business law scandals and corporate governance developments have highlighted the importance of recognizing the external effects of corporate conduct in the public domain and the need to ensure accountability when corporations deviate from the “rules of the game.” They have also revived issues concerning the role and duties of directors, with which Berle and Dodd grappled almost a century ago.

4. Developments Concerning Stakeholders, Corporate Culture and Some Recent Scandals

The pendulum, which swung so clearly in favour of a private conception of the corporation from the 1980s onwards, is arguably in the process of changing direction. There is growing focus on stakeholder interests and the public corporation’s responsibilities to society as a whole. In 2018, for example, Larry Fink, CEO of BlackRock, one of the world’s largest institutional investors, declared that companies “must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.” The US Business Roundtable recently declared a similar goal. The British Academy’s Future

44 See Iwai, supra note 27, at 585; Bratton, supra note 27, at 1472-73.
46 Id.
48 See, e.g., Press Release, Business Roundtable Redefines the Purpose of a Corporation to Promote “An Economy that Serves All Americans” (Aug. 19, 2019), https://www.businessroundtable.org/business-
of the Corporation research project also reflects a return to the idea that corporate purpose needs to be aligned with social purpose. 49

“Corporate culture” is closely connected with these developments. Although the concept has been described as “inherently slippery,” 50 international regulators 51 are now promoting the need for a positive corporate culture. This use of corporate culture in this way is closely tied to the risk of negative externalities and harm to stakeholders and the public. The New York Federal Reserve, for example, recently introduced the idea of “cultural capital” as a way of mitigating misconduct risk in financial institutions. 52

Culture has also become an increasingly important feature of many corporate governance codes. 53 Although these codes, which originated in the United Kingdom, are generally non-binding, they may interact with, and complement, legal duties, including directors’ fiduciary duties. 54 Many codes now explicitly focus on the social role and responsibilities of public corporations. The 2018 UK Corporate Governance Code, for example, notes that the role of a...
successful company is not only to create value for shareholders, but also to contribute to “wider society.”\textsuperscript{55} Furthermore, corporate culture features prominently in The British Academy’s current \textit{Future of the Corporation} research project, as a means of promoting societal trust in corporations.\textsuperscript{56}

Several recent banking scandals demonstrate that poor financial performance, which was regarded as the key agency problem under the law and economics theory of the corporation, is not the only challenge in modern company law. These scandals include the US Wells Fargo fraudulent accounts scandal\textsuperscript{57} and several high profile scandals at some of Australia’s leading financial institutions.\textsuperscript{58} The Australian scandals resulted in two important reports, which suggested that the misconduct identified was directly tied to defective corporate cultures. The first of these reports, by the Australian Prudential Regulation Authority (“APRA Prudential Report”)\textsuperscript{59} in 2018, assessed the governance, culture and accountability structures of the Commonwealth Bank of Australia, after numerous incidents at the bank, including breaches of anti-money laundering and counter-terrorism laws.\textsuperscript{60} The second report by the Australian Banking Royal Commission\textsuperscript{61} examined misconduct in the financial services industry


\textsuperscript{59} See AUSTL. PRUDENTIAL REGULATORY AUTH., PRUDENTIAL INQUIRY INTO THE COMMONWEALTH BANK OF AUSTRALIA (Apr. 30, 2018) (Austl.).

\textsuperscript{60} Id. at 6, 15-16.

\textsuperscript{61} COMMONWEALTH OF AUSTRALIA, ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY TERMS OF REFERENCE (2017) (Austl.).

Although wrongdoing at Wells Fargo and the Australian banks was originally attributed to a “few bad apples,” it later became apparent that there were problems, involving perverse financial incentives, that caused the misconduct. At Wells Fargo, for example, unrealistic sales targets and bonus arrangements induced employees to engage in fraud. More senior bank employees also benefited from the misconduct due to the prevalence of performance-based pay. It seems that compensation incentives may not only encourage wrongdoing, but also undermine its detection. It has recently been argued, for example, that stock-based executive compensation can create systematic perverse incentives to underinvest in compliance programs that could identify misconduct.

The Australian Banking Royal Commission considered that remuneration practices and policies were the main drivers of culture at the relevant financial institutions it examined.

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64 See COMMONWEALTH OF AUSTL., supra note 14. The Australian Banking Royal Commission’s Final Report contained 76 Recommendations. See id. at 20-42.


68 See John Armour et al., Taking Compliance Seriously, 37 YALE J. REG. 1 (2020). Failure to invest in adequate risk management and compliance systems has been raised as a potential problem in a recent scandal, involving serious allegations of compliance failure at Wespace, one of Australia’s four largest banks. See Karen Maley, What The Hell Went Wrong: Bob Joss, AUSTRL. FIN. REV., Nov. 30, 2019 at 15.

69 COMMONWEALTH OF AUSTL., supra note 63, at 301.
Commissioner Hayne, in his interim findings, made the “simple, but telling observation”\textsuperscript{70} that all the impugned conduct delivered financial benefits for the individuals and entities concerned.\textsuperscript{71} The Final Report devoted an entire chapter to “Culture, Governance and Remuneration.”\textsuperscript{72}

These banking scandals highlighted the importance of non-financial risks.\textsuperscript{73} The relevant misconduct and compliance failure benefited shareholders (at least until discovery of the misconduct), while simultaneously harming customers. Indeed, one of the key findings of the APRA Prudential Report was that the exceptional financial success of the Commonwealth Bank of Australia had “dulled the senses” of the institution and senior management to the dangers posed by non-financial risks.\textsuperscript{74} The Australian Banking Royal Commission inquiry also highlighted the danger of reputational loss due to non-financial risks.\textsuperscript{75}

The banking scandals demonstrated that flawed corporate cultures can result in serious harm to stakeholders, such as customers. In the Australian Financial Services Royal Commission’s Final Report, Commissioner Hayne rejected a binary shareholder versus stakeholder approach to corporate law, stating:

"It is not right to treat the interests of shareholders and customers as opposed. Some shareholders may have interests that are opposed to the interests of other shareholders or the interests of customers. But that opposition will almost always be founded in differences between a short-term and longer-term view of prospects and events.”\textsuperscript{76}

Commissioner Hayne also placed blame for the misconduct squarely at the feet of the financial institutions, and their directors and officers. He stated:

\textsuperscript{70} Id.
\textsuperscript{71} Id.
\textsuperscript{72} See COMMONWEALTH OF AUSTL., supra note 14, at Chapter 3.5.
\textsuperscript{73} See AUSTL. SEC. & INV. COMM’N, REPORT 631 CORPORATE GOVERNANCE TASKFORCE – DIRECTOR AND OFFICER OVERSIGHT OF NON-FINANCIAL RISK REPORT (2019) (Austl.).
\textsuperscript{74} See AUSTL. PRUDENTIAL REGULATORY AUTH., supra note 59, at 3.
\textsuperscript{75} See COMMONWEALTH OF AUSTL., supra note 14; AUSTL. SEC. & INV. COMM’N, supra note 73.
\textsuperscript{76} See COMMONWEALTH OF AUSTL., supra note 14, at 403.
“[t]here can be no doubt that the primary responsibility for misconduct in the financial services industry lies with the entities concerned and those who managed and controlled those entities: their boards and senior management. Nothing that is said in this Report should be understood as diminishing that responsibility.”

5. Director and Officer Liability for Breach of the Duty of Oversight: A Comparative Analysis

These financial scandals raise interesting questions about community expectations regarding a “public accountability” role for company directors and officers. A key issue, moreover, is the extent to which those expectations are matched by legal liability.

Since the 1960s, in response to the work of Professor Melvin Eisenberg, independent directors have been viewed as corporate monitors, with a fundamental duty of oversight. This image of directors has been a central aspect of the modern shift around the world towards majority independent boards. However, as another doyen of US corporate law, Professor Victor Brudney, once noted, to describe directors as monitors is not the end of the story – we need to know precisely what it is they are supposed to be monitoring.

77 COMMONWEALTH OF AUSTL., supra note 14, at 4.


79 In a 2017 speech, US Federal Reserve Governor Jerome H. Powell stated “we simply expect much more of boards of directors than ever before. There is no reason to expect that to change.” Jerome H. Powell, Speech at the Large Bank Directors Conference, The Role of Boards at Large Financial Firms, Chicago (Aug. 30, 2017), https://www.federalreserve.gov/newsevents/speech/powell20170830a.htm. The same point was made more than 50 years ago by an Australian High Court judge, who warned that where community expectations lead, the law will usually follow. See Douglas Menzies, Company Directors, 33 Austl. L. J. 156 (1959) (Austl.).


82 See, e.g., INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL, AND COMPARATIVE APPROACH (Dan W. Puchniak et al., eds., 2017).

Brudney suggested at least three possibilities in this regard, which intersect with the division between Berle and Dodd in their famous debate. According to Brudney, independent directors could be described as monitoring: (i) integrity,\(^84\) (ii) efficiency/performance,\(^85\) or (iii) corporate social responsibility.\(^86\)

During the 1990s, the dominance of the law and economics theory of the corporation, coupled with increased interest in corporate governance by financial economists,\(^87\) led to an almost exclusive focus on monitoring of corporate efficiency/performance.\(^88\) To what extent, however, are directors and corporate officers today expected to monitor corporate culture failures that result in negative externalities involving integrity or social responsibility issues? And to what extent can they be liable for breach of their duty of oversight in failing to recognize and address non-financial and ethical risks associated with flawed corporate culture? There are significant differences between the traditional approaches of US, UK and Australian law in this regard.\(^89\)

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84 Professor Brudney focuses on “managerial” integrity (for example, precluding self-dealing by management), though similar arguments can be made in relation to “organizational” integrity. Id. at 607-631, 653.

85 Id. at 632-39.

86 See id. at 602-603, 658. Professor Brudney considered that there are practical difficulties involved in all three types of monitoring, on the basis that the independent director’s leverage is “modest.” Id. at 658-59. In relation to monitoring efficiency, for example, he stated that the generally accepted view is that independent directors “cannot and do not diligently police management’s wealth-maximizing function.” Id. at 638. Cf. Gordon, supra note 81 (arguing that a shift in the role of independent directors from advisors to monitors of shareholder wealth maximization was facilitated by technological and informational improvements regarding stock prices).

87 See, e.g., Gilson, supra note 54 at 5 (noting that, between 1995 and 2013, 25% of all articles in the prestigious Journal of Financial Economics related to corporate governance).

88 For example, Professor Gordon, writing in 2007, stated that the “now-conventional understanding” of directors in public companies is that they are “supposed to ‘monitor’ the managers in view of shareholder interests.” Gordon, supra note 81, at 1468. According to Gordon, the 1990s and 2000s were characterized by a principle of “unalloyed shareholder wealth maximization.” Id. at 1469. See, e.g., Julian Velasco, “Shareholder Primacy in Benefit Corporations,” ch. ___ (this volume) (distinguishing between the wealth maximization norm and shareholder primacy).

89 See generally Hill & Conaglen, supra note 34. For an excellent historical analysis of how US and UK fiduciary law, which had the same roots, came to diverge radically, see DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW (2018). See also Edward J. Janger, “Duty and Clawback in Rescue: Value Maximization in the Zone of Insolvency from A Comparative Perspective,” ch. ___ (this volume) (discussing differences between the approach of US and UK law relating to fiduciary duties in the context of corporate insolvency).
Under US state law, the most important of which is Delaware law, directors have traditionally faced “miniscule likelihood” of liability with respect to their duty of oversight, unless it can be demonstrated that they had actual knowledge of the wrongdoing. The leading modern US case on the duty of oversight is the landmark 1996 decision, *In re Caremark International Inc. Derivative Litigation* (“Caremark”). This case, bolstered by later important decisions, such as *Stone v. Ritter* and *In re Citigroup Shareholder Derivative Litigation*, demonstrated that directors will generally be protected from liability in all but extreme circumstances. Mere negligence is insufficient, given the capacious protection of the business judgment rule. Even gross negligence does not suffice, due to the ubiquitous presence of exculpation clauses in US corporate charters.

According to the *Caremark* case, directors will only be liable for “bad faith” breaches of oversight responsibility, falling within the more stringent duty of loyalty. The court stated that to establish lack of good faith, the plaintiff must show “a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists.” Dicta in the *Disney* litigation and *Stone v. Ritter* went even further, requiring, as a precondition to liability, egregious conduct, in the form of *intentional* infliction of harm or *conscious* dereliction of duty by a director.

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90 See Brudney, *supra* note 83, at 614.


95 Gross neglect (or “crassa negligentia”) was the standard of diligence required under 18th century UK law in the famous case of Charitable Corporation v. Sutton, (1742) 2 Atk 400, 406; 26 ER 642.


Although some scholars have perceived this duty of good faith under US corporate law as implicating a public accountability role for directors,\(^{100}\) the practical effect of the judicial definition of “bad faith” in these decisions was such as to render the US duty of oversight aspirational only.\(^{101}\) In many of the banking scandals, for example, directors and officers were completely ignorant of the misconduct and compliance failures within the organization.\(^{102}\) The narrow contours of the Caremark doctrine led some commentators to question whether investors are, in fact, provided with any “meaningful oversight protection.”\(^{103}\) Although this legal regime is often justified on policy grounds,\(^{104}\) it has recently been claimed that the standard policy arguments do not necessarily justify complete exclusion of liability.\(^{105}\)

Two recent Delaware Supreme Court decisions, however, suggest a judicial shift may be occurring regarding the interpretation of the “good faith”/“bad faith” dichotomy in the Caremark doctrine and that this shift could potentially offer broader scope for liability of directors for public harm caused by corporations.\(^{106}\) The first of these decisions, a 2017 demand futility case, City of Birmingham Retirement and Relief System v. Good,\(^{107}\) highlights the

\(^{100}\) See, e.g., Sale, supra note 15.


\(^{103}\) Bevilacqua, supra note 97. See also Ronald Barusch, CBS and the Need to Hold Directors Accountable, WALL ST. J., Sept. 17, 2018.

\(^{104}\) The high level of protection provided to US directors under the duty of care has sometimes been justified on the basis of the “stupefying disjunction between risk and reward,” which could apply if directors were to be held liable for negligence. See Gagliardi v. Trifoods Int’l, Inc., 683 A. 2d 1049, 1052 (Del. Ch., 1996).

\(^{105}\) Holger Spamann, Monetary Liability for Breach of the Duty of Care?, 8 J. LEG. ANALYSIS 337 (2016). See also Lyman Johnson, “The Three Fiduciaries of Delaware Corporate Law,” ch. __ (this volume) (noting that “a robust duty of care for officers – the law on which is surprisingly undeveloped in Delaware – might revive the prospect of remedies for a care breach by senior executives, who cannot be exculpated”).

\(^{106}\) It should also be noted that directors can potentially be liable under US securities law for oversight failures relating to public responsibilities, where they have made corporate misstatements, even if those misstatements were made in good faith. See Hillary A. Sale & Donald C. Langevoort, “We Believe”: Omnicare, Legal Risk Disclosure and Corporate Governance, 66 DUKE L.J. 763 (2016) (discussing the decision in Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, 575 U.S. __ (2015)).

traditionally narrow scope of *Caremark*-style claims, yet at the same time demonstrates the potential for change. The case involved a claim that the directors of Duke Energy Corp. breached their duty of oversight when the company discharged highly toxic coal ash and waste water into a North Carolina river.\(^{108}\) The majority judgment affirmed the Court of Chancery’s decision that the plaintiffs had failed to show that the directors acted in “bad faith,” the standard for *Caremark*-style oversight liability.\(^{109}\) However, Chief Justice Strine disagreed, and the grounds for his dissenting judgment are noteworthy. He stated that:

“it was the business strategy of Duke Energy, accepted and supported by its board of directors, to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws... Duke’s executives, advisors, and directors used all the tools in their large box to cause Duke to flout its environmental responsibilities, thereby reduce its costs of operations, and by that means, increase its profitability. This, fiduciaries of a Delaware corporation, may not do.”\(^{110}\)

The second case, the 2019 Delaware Supreme Court decision in *Marchand v. Barnhill*,\(^{111}\) involved a suit against the directors of a dairy company, Blue Bell Creameries USA, Inc., which had distributed contaminated ice cream, resulting in the deaths of several customers. The plaintiffs successfully pleaded that the company’s directors were not protected under the *Caremark* doctrine. Although the company had US Food and Drug Administration (“FDA”) compliance systems in place, the court held that the directors had not implemented any “system to monitor food safety at the board level,”\(^{112}\) and that the absence of such board level

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\(^{108}\) See, e.g., Brudney, *supra* note 83, at 603 (discussing the potential role of directors in addressing “the social costs of externalities, such as pollution of the environment”).

\(^{109}\) See *City of Birmingham Retirement and Relief System v. Good*, C.A. No. 9682-VCG (Del. S.C., Dec. 15, 2017), 4, 13 (per Seitz J.).


\(^{111}\) *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019). The parties in *Marchand v. Barnhill* entered into a $60 million settlement on April 24, 2020, shortly before the trial was due to commence. See Meredith Kotler, Pamela Marcogliese & Marques Tracey, *Recent Delaware Court of Chancery Decision Sustains Another Caremark Claim at the Pleading Stage*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, May 25, 2020. The former chief executive officer of Blue Bell Creameries USA, Inc. was also charged with conspiracy in relation to the listeria outbreak. See Christopher Mele, *Blue Bell’s Ex-C.E.O. Charged in Conspiracy to Cover Up Listeria Outbreak*, THE NEW YORK TIMES, May 1, 2020, at A23.

monitoring amounted to “bad faith indifference”\(^{113}\) for the purposes of the Caremark doctrine. Marchand v. Barnhill signals a significant deviation from the previously accepted contours of the Caremark doctrine. It has already been relied upon to support potential Caremark liability in a recent Delaware Court of Chancery decision, In re Clovis Oncology, Inc. Derivative Litigation,\(^ {114}\) and could have major personal liability ramifications for directors and officers in the future.\(^ {115}\)

At first sight, the position in the United Kingdom appears to be quite different from the traditionally narrow contours of US Caremark-style liability. UK directors have been subject to a clear oversight responsibility for financial mismanagement as part of their duty of care and diligence (“duty of care”) since the landmark 1925 decision in In re City Equitable Fire Insurance Co.\(^ {116}\) The standard for this duty, originally one of gross negligence, rose significantly during the 1990s.\(^ {117}\) UK case law also suggests that directors have a responsibility to monitor, from both a competence and an integrity perspective, any functions that they have delegated to other persons in the organization.\(^ {118}\) The 2018 UK Corporate Governance Code states that directors “must act with integrity, lead by example and promote the desired culture.”\(^ {119}\)

\(^{113}\) Id. at 823.

\(^{114}\) In re Clovis Oncology, Inc. Deriv. Litig., C.A. No. 2017-0222 – JRS (Del. Ch., Oct. 1, 2019) (where the plaintiffs alleged that the board directors of Clovis, a pharmaceutical company, had ignored red flags regarding failure by the company to comply with clinical testing protocols for a particular drug, and then allowing Clovis to issue misleading public statements about the relevant drug trials). For discussion of some judicial developments since In re Clovis Oncology, Inc., see Kotler, Marcogliese & Tracey, supra note 111.

\(^{115}\) See Martin Lipton, Wachtell Lipton Memo, Spotlight on Boards, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, Jun. 28, 2019, https://corpgov.law.harvard.edu/2019/06/28/spotlight-on-boards-4/. See also Kotler, Marcogliese & Tracey, supra note 111, arguing that cases, such as Marchand v. Barnhill, represent “unique or extreme examples of certain corporate behavior”, rather than signaling a change in the law.

\(^{116}\) [1925] Ch 407 (U.K.).


\(^{119}\) FIN. REPORTING COUNCIL, supra note 53, at 4.
Although this might suggest that UK directors face a high risk of liability for oversight failure, that is not, in fact, the case. There is a dearth of litigation under the UK’s private enforcement model for breach of directors’ duties. Directors of UK public companies have faced virtually no risk of being sued for damages for breach of their duty of care, even following the global financial crisis, where blame could often be traced to board policies. The reasons for this lack of litigation are mainly procedural, yet they create what has been described as “an accountability firewall” in the United Kingdom.

In spite of some superficial similarities, Australian law relating to directors’ oversight duties differs significantly from the traditional US Caremark standard and UK company law. Australian directors and officers are subject, not only to general law (i.e. common law and equitable) duties, but also to statutory duties under the Corporations Act, including the duty of care, which form part of a broader civil penalty enforcement regime.

In contrast to the strongly private, contractual interpretation of corporate law under contemporary Delaware case law, the Australian courts have increasingly viewed directors’

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120 Note, however, that director disqualification orders, including for recklessness and incompetence are relatively common in the United Kingdom. See generally Davies & Worthington, supra note 118, at [10-2], [10-10], 237-38, 246-47.


122 See Loughrey, supra note 118, at 12-13.

123 Procedural reasons for the negligible UK caselaw on breach of the duty of care include the absence of class actions and the loser-pays litigation system. See generally Marc T. Moore, Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the RBS and Citigroup Litigation, 18 EUR. BUS. ORG. L. REV. 733 (2017); Armour et al., supra note 121; Hill & Conaglen, supra note 34.


125 See Hill & Conaglen, supra note 34.

126 See Corporations Act 2001 (Cth), ss 180-184 (Austl.).

127 Corporations Act 2001 (Cth), s 180(1) (Austl.).


statutory duties as public obligations, which have an important social function. According to the 2011 decision, ASIC v. Healey, “[t]he role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.”

Australian case law also accepts that directors have an obligation to oversee and monitor the activities of their company, and that failure to ensure that the company has proper control systems in place, to enable directors to fulfil their monitoring responsibilities, can constitute breach of the duty of care. These oversight responsibilities may, in certain circumstances, implicate matters traditionally associated with corporate social responsibility, when those matters expose the company to significant risk, including, for example, risks associated with climate change. In the wake of the Banking Royal Commission’s findings, the Australian Securities and Investments Commission (“ASIC”) released a report, which confirms that boards of Australian public companies are responsible for both financial and non-financial risks. The report also emphasizes that these two forms of risk are closely connected, because

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135 A Memorandum of Opinion, co-authored by a senior corporate law barrister, has argued that Australian directors who disregard the risks to their business associated with climate change could potentially face liability for breach of the statutory duty of care. See The Centre for Policy Development and the Future Business Council, Climate Change and Directors’ Duties, Supplementary Memorandum of Opinion (Mr Noel Hutley SC and Mr Sebastian Hartford Davis) (Mar. 26, 2019).

136 See COMMONWEALTH OF AUSTL., supra note 14.

137 AUSTL. SEC. & INV. COMM’N, supra note 73.
“non-financial risks have very real financial implications for companies, their investors and their customers.”138

Finally, in contrast to both the United States and the United Kingdom, Australia relies on a predominantly public, rather than private, enforcement model,139 as a result of its civil penalty regime.140 The 2016 decision, ASIC v. Cassimatis (No 8),142 accepted that breach of the statutory duty of care is not only a private, but also a public, wrong, and that there is a public interest in the enforcement of directors’ duties in Australia.143 Under this public enforcement regime, actions for breach of directors’ duties are usually brought by the business conduct regulator, ASIC. The regulator has a very high success rate in such actions to date,144 and has recently benefited from a major expansion of the sanctions available to it under this regime.145

An increasing number of ASIC’s civil penalty applications in recent times have involved so-called “stepping stone” liability.146 This developing form of liability comprises a two-step process, whereby directors and officers may be personally liable for failure to prevent

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138 Id. at 2.
139 See Armour et al., supra note 121. There are, however, some aspects of public enforcement in the United Kingdom. Id. at 716-17.
140 For a comparison of the US and Australian enforcement models relating to directors’ duties, see Renee M. Jones & Michelle Welsh, Toward a Public Enforcement Model for Directors’ Duty of Oversight, 45 VAND. J. TRANSNAT’L L. 343 (2012).
141 Corporations Act 2001 (Cth), Part 9.4B; s 1317E(1) (Austl.).
142 ASIC v. Cassimatis (No 8) [2016] FCA 1023 (Austl.). An appeal against this decision was dismissed in March 2020 by the Federal Court of Australia in Cassimatis v. ASIC [2020] FCAFC 52 (Austl.).
143 See ASIC v. Cassimatis (No 8) [2016] FCA 1023, [455], [461], [503] (Austl.). See also Cassimatis v. ASIC [2020] FCAFC 52, [27], [240] (Austl.).
146 On the evolution of “stepping stone” liability, see Abe Herzberg & Helen Anderson, Stepping Stones - From Corporate Fault to Directors’ Personal Civil Liability, 40 FED. L. REV. 181 (2012); Tim Bednall & Pamela Hannahan, Officers’ Liability for Mandatory Disclosure: Two Paths, Two Destinations?, 31 CO. & SEC. L.J. 474 (2013).
contraventions of the law by their corporation. In recent stepping stone liability cases, ASIC has argued that directors breached their statutory duty of care by allowing the corporation to contravene another provision of the Corporations Act, thereby jeopardizing the corporation’s interests by exposing it to a penalty. Stepping stone liability is particularly well-suited to the kind of misconduct that results in stakeholder or social harm. The Banking Royal Commission criticized ASIC for its frequent use of enforceable undertakings (a form of negotiated settlement, not dissimilar from deferred or non-prosecution agreements), rather than pursuing litigation against regulated entities and their directors and officers. ASIC has responded by indicating that it intends to use its enforcement powers more aggressively in the future.


See, e.g., ASIC v. Maxwell [2006] NSWSC 1052, [104]-[106] (Austl.). See generally Harris et al., supra note 130. Although some judges have expressed concern about stepping stone liability being used as a back-door means of imposing accessory liability on directors, this type of liability has been successful in a number of recent Australian cases. See, e.g., ASIC, in the matter of Sino Australia Oil and Gas Ltd (in liq) v. Sino Australia Oil and Gas Ltd (in liq) [2016] FCA 934, [85]-[86] (Austl.); ASIC v. Cassimatis (No 8) [2016] FCA 1023 (Austl.). See Ramsay & Saunders, supra note 144, at 519. However, in Cassimatis v. ASIC [2020] FCAFC 52 (Austl.), the judges expressed doubt as to the value of the term, if not the concept, of “stepping stone liability”, as an analytical tool for assessing breach of s 180(1) of the Corporations Act 2001 (Cth) (Austl.). See id. at [79], [221], [465].

See COMMONWEALTH OF AUSTL., supra note 14.


See COMMONWEALTH OF AUSTL., supra note 14, at 440-42. Note, however, that a recent interim discussion paper on corporate criminal liability by the Australian Law Reform Commission (“ALRC”) has suggested that current Australian law may inappropriately target directors for corporate misconduct, while providing too many opportunities for senior officers to evade personal liability. AUSTL. L. REFORM COMM’N, DISCUSSION PAPER 87, CORPORATE CRIMINAL RESPONSIBILITY, Nov. 2019, [7.30]-[7.33]. See generally id, [7.19]-[7.66]. See also Johnson, supra note 105 (distinguishing between the fiduciary duties owed by executive officers and directors under Delaware Law). On the issue of individual liability of directors and officers for corporate misconduct, see also AUSTL. L. REFORM COMM’N, CORPORATE CRIMINAL RESPONSIBILITY: INDIVIDUAL LIABILITY FOR CORPORATE MISCONDUCT: AN UPDATE, Mar. 2020, in which the ALRC confirms its view that there is an “accountability gap” under Australian law in terms of in terms of holding senior officers of large corporations liable for corporate misconduct. Id. 4. See also DEPARTMENT OF THE TREASURY (CTH), IMPLEMENTING ROYAL COMMISSION RECOMMENDATIONS 3.9, 4.12, 6.6, 6.7 AND 6.8 FINANCIAL ACCOUNTABILITY REGIME: PROPOSAL PAPER, Jan. 2020.

In the Banking Royal Commission’s Final Report, Commissioner Hayne stated that the regulator’s first question, upon becoming aware of any entity’s breach of the law, should be “Why not litigate?” COMMONWEALTH OF AUSTL., supra note 14, at 427. It is anticipated that this will result in a far greater volume of litigation, including for breach of statutory directors’ duties, in the future. See, e.g., Michael Pelly, ASIC Set for Hayne Court Blitz, AUSTL. FIN. REV., Aug. 19, 2019 (Austl.). See also AUSTL. SEC.
6. Conclusion

Underlying business history and theory, there is a tension between the public and private conceptions of the corporation. This tension is embodied in the famous Berle-Dodd debate, in which the two sides to the debate are often viewed as binary and irreconcilable. The Berle-Dodd debate provides the basis for contemporary clashes between “different visions of corporatism,”\textsuperscript{153} such as the conflict between shareholder primacy and stakeholder-centered versions of the corporation.\textsuperscript{154}

This chapter provides two central insights. The first is that there is not one problem, but multiple problems in corporate law, and that different problems may come to the forefront at different times. Although financial performance is a legitimate concern in corporate law, it is also important to recognize, and address, the danger that corporate conduct may result in negative externalities and harm to society. It is, therefore, a mistake to view the two sides of the Berle-Dodd debate as binary and irreconcilable. The second insight is that corporate governance techniques (such as performance-based pay), which are designed to ameliorate one problem in corporate law,\textsuperscript{155} can at the same time exacerbate other problems.

A number of recent developments in corporate law have highlighted the negative externalities and social harm that corporate actions can cause. These developments suggest the emergence

\textsuperscript{153} Bratton & Wachter, supra note 41, at 124.


\textsuperscript{155} For example, performance-based pay, which is designed to address agency problems related to financial performance, can provide perverse incentives for misconduct affecting stakeholders and society. See, e.g., COMMONWEALTH OF AUSTL., supra note 14, at 347-74.
of a more cohesive vision of the corporation that encompasses both private and public aspects. They also potentially affect the role and duties of company directors, who are no longer seen merely as monitors of corporate performance, but also as monitors of corporate integrity and the risk of social harm.
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