Constituency Directors, Loyalty, and the Corporate Objective

Author : Christopher M. Bruner

Date : March 1, 2016

Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?*, 2015 **U. Ill. L. Rev.** 1069 (2015).

Theories of corporate law and governance that purport to explain the nature of the corporate entity, the legitimate objective of corporate decision-making, and/or the balance of corporate power have proliferated over recent decades, and the debates prompting them show no signs of abating. Some accounts place the shareholders' interests at the core of the enterprise, while others present more embracing conceptions requiring (or at least permitting) regard for other "stakeholders" such as employees and creditors. Similarly, some accounts identify shareholders as the font of legitimate corporate power, while others present more board-centric conceptions. Adding to the complexity, various theories combine differing perspectives on the corporate objective and corporate power in differing ways, often rooting them in irreconcilable conceptions of what the corporate entity itself fundamentally is. As time passes, the arc of corporate theory would appear to bend toward fragmentation rather than closure.

In the article cited above, Martin Gelter and Geneviève Helleringer illuminate these issues from a fascinating doctrinal perspective, exploring what the persistence of so-called "constituency directors" – placed on the board by a particular individual or institution – reveals about the nature and defining objective of corporate decision-making. Gelter and Helleringer bring to the task not only deep engagement with the scholarly literature in these areas, but also considerable comparative and interdisciplinary sophistication. Drawing upon a broad range of examples from U.S., U.K., and Continental European corporate legal systems, they observe a "fundamental contradiction" manifesting itself in all of them – "the tension between the uniformity of directors' duties and the heterogeneity of directors themselves." Specifically, they identify an apparent "paradox" in permitting "directors' nomination rules linked to specific constituencies" while at the same time imposing "heterogeneity-blind duties." Building on their descriptive account of illustrative doctrinal structures, Gelter and Helleringer assess them against prevailing formulations of the corporate objective, social scientific insights, and the available empirical evidence, concluding with a normative case for reform. Their product is informative, insightful, and a pleasure to read.

Whether the director in question is a venture capital investor's nominee, increasingly common in the United States; an employee representative appointed under a Continental European codetermination system; a minority shareholder representative; or even a government representative (with which even the United States has some recent experience under TARP), directors' duties remain undifferentiated. "In spite of the heterogeneity of directors between and within countries," Gelter and Helleringer find, "all major jurisdictions, of which we are aware, developed a strongly uniform duty of loyalty for all directors." While such issues have historically loomed larger elsewhere, Gelter and Helleringer rightly observe that their salience in the United States has increased as defined contribution pensions and greater institutional dominance have produced a more active and heterogeneous investor base.

In such situations, the potential for cognitive dissonance blurring into outright conflict of interest is obvious and acute, and structures permitting constituency directors have remained workable only because of another (perhaps ironic) commonality that all such jurisdictions share, which is that "the purported objective of fiduciary duty – however formulated in theory – is not clearly defined at all." Directors are instructed to pursue the best interests of "the company" or "the corporation," whatever that means. Sometimes there is a simultaneous nod toward the interests of the shareholders, an instruction that effectively remains unenforceable due to structures substantially insulating board discretion (e.g. the business judgment rule). Accordingly, while clear self-dealing may be aggressively policed, more general and pervasive conflicts pertaining to business policy typically will not. For lack of any coherent substantive definition, the corporate objective effectively has been "procedurally" defined through board appointment rules – and in such cases the outcome will, as an empirical matter, often "look more like negotiation between different groups than deliberation for a common purpose."

A particularly important question reflecting these dynamics, Gelter and Helleringer suggest, is whether constituency directors ought to be permitted to share nonpublic information with the entity appointing them. While directors "are typically subject to a duty of confidentiality that prohibits them from sharing nonpublic information from the company with their sponsor," Gelter and Helleringer argue in their normative discussion that "permitting firms to opt out of confidentiality" may be desirable – at least where the board appointment structure effectively amounts to a negotiated resolution to long-term contracting problems among various stakeholders.

This intriguing line of normative argument could be refined and taken further, and perhaps will be in future work. Regardless, Gelter and Helleringer's article is a rewarding read, offering a rigorous, nuanced, and insightful analysis of constituency directors and their implications for prevailing conceptions of the duty of loyalty and the corporate objective.

Cite as: Christopher M. Bruner, *Constituency Directors, Loyalty, and the Corporate Objective*, JOTWELL (March 1, 2016) (reviewing Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?*, 2015 **U. Ill. L. Rev.** 1069 (2015)), http://corp.jotwell.com/constituency-directors-loyalty-and-the-corporate-objective/.