PATH DEPENDENCE, SYSTEMIC WILL, AND THE TRANSFORMATION OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW†

David Kershaw, The Foundations of Anglo-American Corporate Fiduciary Law (Cambridge University Press, 2018)

*Reviewed by Robert M. Yalden**

David Kershaw sets out an ambitious agenda: demonstrating how careful examination of the "pre-history" of corporate fiduciary law in the United Kingdom and the United States up-ends traditional accounts of how the law is shaped in each jurisdiction.[1] The book is not for the faint of heart. It examines a large body of case law and requires, but then rewards, close reading. Kershaw builds his arguments methodically, moving from case to case and jurisdiction to jurisdiction over three centuries as he paints a complex picture of competing intellectual currents. In the process, he covers terrain that has not previously been explored in such depth.[2] What emerges are important insights into the way in which legal ideas evolve in common law jurisdictions, as well as a set of claims about the development of corporate fiduciary law that challenge prior accounts. The book will be of considerable interest to anyone interested in the evolution of corporate fiduciary law, especially in jurisdictions influenced by the United Kingdom and the United States, but also to comparativists interested in deep comparative exploration of case law across related but distinct jurisdictions.

Kershaw explores four sets of issues and ideas central to Anglo-American corporate fiduciary law: (i) business judgment and the idea of honesty; (ii) the duty of care and the idea of reward and undertaking; (iii) self-dealing and the idea of the corporation; and (iv) connected assets and the idea of property. The discussion of each topic is largely self-contained. However, throughout the book, Kershaw develops overarching propositions that he refines as he moves along. At least four are worth considering:

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1. Kershaw uses the term "pre-history" to describe the body of legal concepts and doctrinal structures upon which contemporary corporate law is built, but which are largely unknown to the discipline: *see* David Kershaw, The Foundations of Anglo-American Corporate Fiduciary Law 1 (2018).

2. Articles exist comparing directors' duties in the two countries, but nothing that reviews corporate fiduciary law in nearly the level of detail that Kershaw's book does. *See, e.g.*, Kenneth W. Nielsen, *Directors' Duties Under Anglo-American Corporation Law*, 43 U. Det. L.J. 605 (1966).

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(i) Constituencies in the United Kingdom and United States have long called for greater director accountability, but their impact has been overstated.[3]

(ii) The classic narrative that Delaware is especially innovative and adept at navigating competitive pressures and responding to economic policy considerations is flawed: Delaware's judiciary has not, in fact, been particularly innovative, instead borrowing regularly from other jurisdictions without acknowledging that it was doing so.[4]

(iii) Delaware has developed its law in alignment with standards that have long governed elsewhere and that have also long had a pro-directorial bent. Kershaw submits that this is what makes Delaware so attractive to companies: Delaware law generates "normal" outcomes that maintain legal tradition.[5]

(iv) Both the United Kingdom and the United States display deep path dependence: law may respond instrumentally to economic pressures, but it does so through existing rules, principles and structures. These systemic constraints shape the way law responds to pressures, as well as the path that law crafts through interaction with these pressures.[6]

These propositions are what bind the book together. To assess how effectively they are developed and how complete Kershaw's account is, this Review examines how he constructs each part of the book. In the process, it questions whether Kershaw's intense focus on case law comes at the expense of a developed perspective on the role that legislatures play in driving reform.

I. Business Judgment and the Idea of Honesty

Kershaw begins by comparing how the United Kingdom and the United States defined the judiciary's role in reviewing how directors make business decisions. From the outset, the United Kingdom focused on whether delegated power was exercised honestly, rather than on the reasonableness of a given decision.[7] However, Kershaw contends that, over time, rules used initially only as "proxies" for the presence or absence of good faith became stand-alone rules.[8] This gave rise to a tension still seen today between a standard that focuses solely on good faith and an approach (applied when there are indirect conflicts between personal and corporate interests) that places good faith alongside a separate reasonableness standard.[9]

Kershaw then reviews developments in several U.S. states. Courts relied on U.K. precedents early on, and by the 1970s Delaware

3. Kershaw, *supra* note 1, at 57.
4. *Id.* at 19.
5. *Id.* at 19, 226–27, 365.
6. *Id.* at 287.
7. *Id.* at 131.
8. *Id.* at 33.
9. *Id.* at 47–48.

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law also displayed tensions between different standards.[10] But in the 1980s, Delaware's courts sought to resolve matters by elevating a "two standard" approach, such that informed judgment, good faith, and the absence of self-dealing became preconditions to the application of a distinct business judgment review standard.[11]

Kershaw takes issue with the prevailing account that Delaware was particularly innovative as it navigated competitive pressures from other states and the federal government and responded to economic policy considerations.[12] He stresses that prior to the 1980s, the regulation of business judgment was in fact consistent across U.S. states and the United Kingdom.[13] Moreover, the law that emerged in Delaware in the 1980s is functionally identical to what was in place in the eighteenth and nineteenth centuries. Delaware law therefore cannot be understood purely as a response to policy concerns.[14] Instead, Kershaw argues that change was a product of Delaware's efforts to establish its identity as the leader in U.S. corporate law, an exercise in self-definition that prompted it to characterize its corporate law as a unique product of its own judicial and legislative decisions. Delaware developed "a systemic 'will' that consciously avoided situating Delaware law within legal traditions created long before Delaware had any case law."[15]

At first blush, Kershaw's thesis about Delaware's "systemic will" sounds like the claim it purports to reject: that Delaware's position today is a product of a conscious effort to position Delaware as the United States' leading corporate law jurisdiction. But Kershaw's contention—that Delaware law, while distinctive, is nevertheless profoundly shaped by tradition—is a provocative departure from the classic narrative. The argument is a subtle one: even while seemingly responsive to concerns about directorial accountability, Delaware courts continued to exhibit considerable deference to a board's business decisions, as dictated by longstanding intellectual currents.

In challenging legal realist arguments for the originality of Delaware law, Kershaw is at his best. His meticulous review of centuries of case law, which shows the links between developments in other jurisdictions and the evolution of Delaware's common law, makes his conclusions hard to resist. Yet in reading Kershaw's arguments about systemic will, one cannot help but wonder what room his focus on judicial reasoning leaves for legislatures. The question is important because a core part of the case for Delaware law as a response to competitive pressures stresses the many legislative amendments to the

10. *Id.* at 92, 96. Del. Code tit. 8, §141(a) states: "(a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."

11. Kershaw sees *Aronson v. Lewis*, 480 A.2d 619 (Del. 1984) as pivotal in this regard.

12. For a good summary of the classic narrative, see Kershaw, *supra* note 1, at 17–19, 130–33.

13. *Id.* at 131.

14. *Id.* at 132.

15. *Id.*

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Delaware Corporate Code that gave boards of directors an enhanced ability to take action without the need for shareholder approval.[16]

II. The Duty of Care and the Idea of Reward and Undertaking

Kershaw next turns to directors' duty of care in making decisions. He explores how standards of care evolved in the United Kingdom and the United States, yielding a relatively low standard in Delaware that calls for little more than the absence of gross negligence, and a more demanding reasonable care standard in the United Kingdom. His thesis is that these standards are not, as is commonly assumed, the product of attempts to borrow and adapt concepts from the law of agency, trusts, or negligence; rather, they result from judicial adaptation of concepts from the law of bailment.

Kershaw reviews eighteenth and nineteenth century U.K. and U.S. bailment law to show how courts drew on this law to develop standards of care that they applied to corporate directors. Of particular interest is Kershaw's suggestion that, whereas U.S. bailment law emphasized proportionality between the reward for one's services and the degree of care expected, U.K. bailment law placed greater moral weight on the nature of the bailee's undertaking.[17] Nevertheless, Kershaw contends that the "gross negligence" standard that emerged in the United States was in fact remarkably consistent with the United Kingdom's care standard, and that in both jurisdictions the degree of care was situation dependent.

Returning to one of his central themes, Kershaw notes that while states like New York and Pennsylvania were forthright about their reliance on bailment jurisprudence, Delaware came to the table much later and borrowed copiously without acknowledging that it was doing so.[18] The result was a conception of gross negligence that embraced a situation-adjusted ordinary care standard.[19] But Delaware then adopted a distinction between a higher standard of care required of directors in their conduct and a less demanding standard with respect to business decisions in cases that are "actionable" for gross negligence.[20] This distinction has generated confusion since in practice the standard that matters is the one that is actionable (i.e., the lower standard). But Kershaw suggests that any uncertainty generated by Delaware's reformulation was outweighed by its commitment to maintaining the legal status quo with its pro-directorial bent.[21]

Kershaw also reviews a line of criticism in the United Kingdom, dating back to the nineteenth century, seeking to hold directors to a higher standard. He argues that while a recent codification was

16. See, e.g., a summary of this thesis provided in (and then in some respects challenged by) Ralph K. Winter Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Leg. Stud. 251, 254–55 (1977).

17. Kershaw, *supra* note 1, at 141.

18. *Id.* at 199.

19. *Id.* at 210 (where Kershaw notes that the Delaware courts today call this a "reasonable care standard").

20. *Id.* at 185, 221–23.

21. *Id.* at 226.

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intended to introduce a tougher standard, in practice there has not been any meaningful shift. Statutory provisions which set out the directorial duty of care (in particular section 174 of the Companies Act 2006) have in the end been viewed by courts through the lens of the common law.[22] Courts have largely ignored language in section 174(2)(b) that adjusts the care standard according to a director's actual skill level, instead applying the longstanding "situation-adjusted average director standard."[23]

While Kershaw's arguments are thorough, there is an unacknowledged tension running through them: on the one hand, criticism of those who fail to recognize the flexibility in U.K. common law, which has been appropriately responsive to concerns about directorial accountability; on the other hand, the suggestion that notwithstanding judicial reformulation in Delaware and legislative initiatives in the United Kingdom, both jurisdictions' standards are similarly pro-director. Kershaw implies that the courts have by and large struck the right balance: favoring respect for directorial autonomy, qualified only as necessary. The deeper policy question that remains unexplored is whether this really is a satisfactory way to balance autonomy and accountability and, even if it is, whether it is appropriate for courts to ignore legislative guidance intended to enhance accountability. One cannot help but ask what Kershaw's account teaches us about how legislatures should craft reform in the face of a judiciary beholden to systemic constraints.

III. Self-Dealing and the Idea of the Corporation

In the third part of the book, Kershaw explores why the United Kingdom and the United States started out applying the same fiduciary principle to self-dealing by directors,[24] but ended up with starkly different approaches: the United Kingdom uninterested in whether a self-dealing contract is fair to the company and making such contracts voidable by the company in the absence of prior authorization or subsequent ratification; the United States taking the position that such contracts are enforceable, subject to fairness review by courts if challenged.[25]

Fundamental to this divergence was the influence of distinct conceptions of the corporation. In an illuminating chapter, Kershaw

22. Companies Act 2006, c. 46, § 174 states:

> (1) A director of a company must exercise reasonable care, skill and diligence.
> (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
> (b) the general knowledge, skill and experience that the director has.

23. Kershaw, *supra* note 1, at 279.

24. In both cases relying on the decision in *Aberdeen Railway Co. v. Messrs. Blaikie Brothers* (*Aberdeen*) (1854) 1 Macq. 461 (HL).

25. Kershaw, *supra* note 1, at 285–86.

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explores the historical origins of these conceptions.[26] In the United Kingdom, nineteenth-century courts saw the then new generally incorporated company not as a distinct legal entity but as a continuation of the unincorporated company: a product of private contract whose governance was therefore open to variation by its shareholders.[27] In the context of self-dealing, this entity myopia led U.K. courts to draw on the treatment of self-dealing in the law of trusts. Accordingly, a strict default rule was adopted such that directors could not enter into self-dealing transactions,[28] although, as in the law of trusts, shareholders could contract out of the default position.[29] Many companies therefore included terms in their articles of association providing that if a director disclosed the interest and disinterested directors approved the transaction, then the self-dealing director could keep any profit. This contractual solution meant that courts in the United Kingdom never had to explore whether fiduciary law might allow for a more flexible standard.[30]

In the United States, however, generally incorporated companies were viewed as having a profoundly public character.[31] Their structure and powers were seen as products of state action and not amendable without state approval.[32] Since this vision limited the extent to which shareholders could contract out of the default rules, responses to pressure to allow self-dealing transactions had to come from the law itself, giving rise to fairness review.

Kershaw attacks the claim that U.S. law passed through distinct and sequential stages on its way to adopting a fairness standard.[33] He suggests this view remains popular because it fits with the classic narrative of economic considerations yielding management-friendly solutions. But in fact, fairness-based rules had long existed in New Jersey and New York, which in turn influenced Delaware.

Kershaw's methodical review of how conceptions of the corporation shaped each country's approach to self-dealing is compelling. But there is once again tension, this time between Kershaw's desire to show how deeply rooted Delaware's approach is in ideas that had long circulated in other states and his suggestion that Delaware exhibited a "systemic will" to avoid situating Delaware within these legal traditions.[34] This tension permeates the book as a whole. A more detailed account of systemic will would have been welcome, particularly with respect to the relative roles of the legislature and the courts in shaping systemic will. The question is whether effecting systemic change requires particular determination on the part of a legislature

26. *Id.* at 285–308.
27. *Id.* at 296.
28. *Aberdeen*, (19854) 1 Macq.
29. Imperial Mercantile Credit Ass'n v. Coleman (1871) L.R. 6 Ch. App. 558 (Eng. CA).
30. Kershaw, *supra* note 1, at 318.
31. *Id.* at 301.
32. *Id.* at 303.
33. *See*, *e.g.*, Harold Marsh Jr., *Are Directors Trustees?*, 22 Bus. L. 35 (1966).
34. Kershaw, *supra* note 1, at 132.

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(i.e., political will), or whether systemic will is such that the courts can and must contribute to reorienting legal principles and, if so, how best to understand the nature of their interaction with the legislature.

IV. Connected Assets and the Idea of Property

In the last part of the book, Kershaw considers when directors or officers may profit personally from information about a business opportunity or asset relating to the corporation. Kershaw refers to these as "connected assets" and seeks to understand how, once again, the United Kingdom and the United States started from the same place in the nineteenth century but diverged: the United States now permitting directors to seek out opportunities in their personal capacities, while the United Kingdom does not.[35]

Kershaw notes that initially both U.K. and U.S. courts drew on case law dealing with other kinds of fiduciaries, notably trustees, and that their approaches remained aligned for over a century. Up until the 1970s, in both countries, absent a sufficient connection between the company and the opportunity, a director would not have to account for profits realized from the opportunity. But Kershaw emphasizes that missing was a fully developed "justificatory theory of property in relation to such assets" which could provide a robust explanation of why the information or opportunity was company property.[36] U.S. courts, drawing on Lockean ideas about property, would ultimately prove better able to develop this foundation.

Kershaw contends that underdeveloped ideas about property led the United Kingdom to abandon the "lens of property," eventually embracing a rigid approach to the no-conflict rule that applied to any conflict between a director's personal interest and the general corporate interest. This approach was codified as the United Kingdom's statutory connected asset rule in section 175 of the Companies Act 2006 (the Act).[37] But in some of the more forcefully worded pages in the book, Kershaw argues that the Act now "creates an irreconcilable contradiction within U.K. fiduciary law."[38] The Act's general codification of directors' duties was not in his view intended to alter the common law. Yet section 175 includes wording that is out of step with the overall weight of common law and that imposes an unnecessarily rigid anti-director approach.[39]

In the United States, Kershaw traces the origins of connected asset law to nineteenth-century New York, where the courts drew on the United Kingdom's early pro-director approach. These strands were then synthesized in important Alabama decisions, with the result that where a director took advantage of an opportunity not subject to any prescriptive duty rooted in the asset being company property, the director was entitled to keep the opportunity.[40] At the same time, an

35. *Id.* at 401–02.
36. *Id.* at 383, 393–97.
37. *Id.* at 405, 409–13.
38. *Id.* at 426.
39. *Id.* at 424.
40. *Id.* at 438.

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alternative body of law, employing the language of "corporate interests" (as in the United Kingdom) rather than of "property," developed in some U.S. states. The Delaware courts have tried to harmonize these distinct approaches, but the attempt has left "a deep conceptual indeterminacy at the heart of Delaware connected assets law, because these two lenses cannot be combined."[41]

Once more, Kershaw rejects a narrative about competitive federalism or instrumentalist policy choices; indeed, the chronology and geography of sources he unearths contradict this conventional account. But in an interesting passage that suggests that he is not quite as dismissive of arguments about competitive federalism as he would have us believe, he contends that, to the extent that some degree of competition exists in the United States, it has insulated Delaware's substantive rules from anti-director reform pressures.

While Kershaw's methodical approach to case law continues to prove effective, his analysis of the legislative side of the equation is again less developed. His frustration with where the United Kingdom has gone with the adoption of section 175 of the Act and its imposition of a rigid no-conflicts-of-interest rule leads him to make arguments that are less textured and measured than his rigorous investigations of the common law. One is left wondering whether deeper analysis is needed of the legislative intent behind sections 170 to 177 of the Act, in particular the extent to which the legislature intended to have the Act merely reproduce systemic constraints embedded in the common law.

Kershaw acknowledges that, in recent years, the United Kingdom's legislature and courts have been more responsive than Delaware's to pressure for greater directorial accountability. Even though in Part II of the book he explains that U.K. courts have at times ignored statutory reform when dealing with the directorial duty of care, in Part IV he concludes that competitive federalism in the United States provides a counterbalance to pressures for reform that has no equivalent in the United Kingdom.[42] This may be the case, but it is also possible that social democratic currents form a more integral part of the United Kingdom's political lifeblood than of the United States', and that in the United Kingdom there has therefore been more political appetite for increased director accountability. Put another way, competitive constraints on legislative action are relevant, but they are not the whole story. Whether there is genuine political will to effect change is also relevant, and it is worth better understanding the sources of political will for corporate law reform, and why it leads to change in some contexts and countries but not others. More analysis comparing the history and influences that have shaped legislative agendas in the United Kingdom and the United States would serve to enrich the discussion, as would greater attention to delineating the balance of influence between political will and judicial will in driving or inhibiting change in each country.

41. *Id.* at 458.
42. *Id.* at 468.

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Conclusion

Kershaw's achievement is significant. He has dug more deeply into the origins of Anglo-American corporate fiduciary law than anyone has before and he provides a rich and textured picture of how the common law evolved in its early days in the United Kingdom, laying the groundwork for developments in the United States that he reviews with equal care. One emerges from reading Kershaw's book with a heightened awareness of the complex and nuanced currents of jurisprudential thinking about corporate fiduciary law in both countries. Advocates of theories about competitive federalism or instrumentalism will have to contend with Kershaw's carefully constructed arguments about the importance of historical path dependence and systemic constraints.

At the same time, the book leads one to ask whether there might not be more to the story. In some respects, Kershaw acknowledges that there is: Delaware manifested a "systemic will" to position its law to attract companies seeking comfort that Delaware would replicate existing legal traditions, while the United Kingdom's legislature and courts have shown a greater willingness to push for enhanced director accountability. In both jurisdictions, we therefore see decisions being made by legislatures and courts about whether to move the law in a particular direction, frequently generating divergent outcomes. All of this means that systemic constraints may not be as determinative as Kershaw suggests. Legislatures have long played a role in defining corporate law, and in some countries, like the United Kingdom, are very much involved in shaping corporate fiduciary law. Courts have undoubtedly been measured in their innovations, and it is one of the great strengths of Kershaw's book that he shows us just how deliberate courts can be in a common law system. But courts are not immune to popular sentiment (as expressed through legislation and otherwise) and play their role in conjunction with legislatures to ensure that corporate law is periodically realigned.

The evolution of U.K. and U.S. corporate law statutes in the nineteenth century, and well into the twentieth century, reflected significant pro-directorial currents that Kershaw reveals were already at play in the common law. But concern about directorial accountability has never disappeared, and more recent experience suggests that this preoccupation will continue to influence legislatures. The challenge moving forward is to marry our understanding of the evolution of judicial thinking, now significantly enriched as a result of Kershaw's contribution, with an equally sophisticated comparative analysis of the history, role and relative importance of legislatures in shaping corporate fiduciary law.

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