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John K. Wells

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MULTIPLE DIRECTORSHIPS: THE FIDUCIARY DUTIES AND CONFLICTS OF INTEREST THAT ARISE WHEN ONE INDIVIDUAL SERVES MORE THAN ONE CORPORATION

JOHN K. WELLS*

INTRODUCTION

In the modern corporate world, it is not uncommon for one individual to serve as an officer of more than one corporation, to sit on more than one board of directors, or to list more than one occupation as a full-time job. Such individuals are known as "dual" or "multiple" officers or directors, depending on the number of corporate boards upon which they serve.[1] Dual and multiple directorships give rise to numerous questions, as illustrated by the following hypothetical situation.

John Smith is the Chief Executive Officer and Chairman of the Board of Corporation A (A Corp.). Mr. Smith is also the CEO and Chairman of the Board of Corporation B (B Corp.), which A Corp. created as a wholly owned subsidiary. When A Corp. formed B Corp., Mr. Smith thought little of the dual nature of his duties as an officer and director of both companies. He presumed that since A Corp. owned 100% of the shares of B Corp., his duty rested primarily with A Corp. After a period of time, however, A Corp. sold a small interest in B Corp. to a third party, thus creating a minority interest in B Corp. At that time, Mr. Smith became more concerned about his duties to B Corp. Did he owe a fiduciary duty to the minority shareholders of B Corp.? Last year, A Corp. negotiated the spin-off of B Corp. As a result, A Corp. now owns only a small interest in B Corp. Mr. Smith, however, retained his

* The Author is an attorney in the firm of Brock, Clay, Calhoun, Wilson & Rogers, P.C., in Atlanta, Georgia. Mr. Wells holds a B.A. from the University of Tennessee, Knoxville, and a J.D. from Georgia State University.

1. *See, e.g.*, Meyerson v. El Paso Nat. Gas Co., 246 A.2d 789, 791 (Del. Ch. 1967) (discussing "dual officers" violating their fiduciary duty); Martin Found. v. North Am. Rayon Corp., 68 A.2d 313, 315 (Del. Ch. 1949) (describing a "dual director's" interest involving a subsidiary or affiliate); Darren K. Skinner, *Unlocking the Interlocks: Common Law Fiduciary Duties and the Phenomenon of Interlocking Corporate Directories in the Commonwealth Caribbean*, 3 J. TRANSNAT'L L. & POL'Y 53, 77 (1984) (using the phrase "multiple director").

positions as Chairman and CEO of B Corp. following the spin-off.

After giving some thought to the matter, he is now thoroughly confused as to whom he owes the fiduciary duties of loyalty and care. Of concern to Mr. Smith is whether, as an officer and director of A Corp., he still owes a fiduciary duty to the shareholders of B Corp., since A Corp. no longer owns a majority interest in B Corp.

An equally perplexing question to Mr. Smith is, as an officer and director of more than one corporate entity, which entity should he spend the majority of his time working for? Does he violate a fiduciary duty to one if he devotes more time to the other? What happens if his duties to one corporation prevent him from adequately serving the other?

In addition, the potential for a conflict of interest is greater now that B Corp. is an independent corporation, no longer under the control of A Corp. As a wholly owned subsidiary, B Corp. was never in danger of competing with A Corp. Now, however, Mr. Smith is wary that B Corp., since it operates in a similar business with A Corp., may be a future competitor of A Corp. As an officer and director of both, to whom does he owe a duty of loyalty? Can he remain fair and impartial, or does the potential for conflict require him to resign from one of the corporations? Complicating matters further is the fact that last year, Mr. Smith accepted an invitation to serve on the board of directors of C Corp., a corporation wholly independent of either A Corp. or B Corp. Mr. Smith is now reflective of that decision, knowing that his time is already stretched thin in light of his duties at A Corp. and B Corp. His concern is that if he cannot spend an adequate amount of time serving C Corp., he may breach his fiduciary duty to the shareholders of that corporation as well.

Mr. Smith is in a quandary. He is an experienced corporate officer and director with over thirty years of business experience, but has never thoroughly contemplated the duties he owes to the entities and constituencies that he serves. In the past year, with the spin-off of B Corp. and the additional directorship at C Corp., he has been worried that perhaps even the most benign actions on his part could subject him to liability for breach of fiduciary duty. As a result, he has finally decided to seek legal counsel on the nature and extent of his duties as a multiple corporate officer and director.

As the hypothetical illustrates, dual and multiple directorships present a host of problems of which a large number of corporate officers and directors may be unaware. Unfortunately, the courts have given little guidance in the area of dual and multiple directorships. Most reported cases that touch on the issue do so merely in passing, without addressing the

specific problem of the overreaching corporate director or officer. In addition, the vast majority of those cases that address these issues at some level involve conflicts between parent and subsidiary corporations, leaving completely unaddressed a wealth of problems in other conflict situations. Finally, precious little legal literature devoted to the unique problems inherent in the multiple directorship context exists.

This Article, through an analysis of the limited case law pertaining to dual and multiple directorships in the Delaware courts, will attempt to explore the conflicts presented and the duties that arise out of the dual and multiple directorship problem. In doing so, this Article will attempt to answer many of the questions posed by Mr. Smith's hypothetical dilemma.

I. THE HISTORICAL PERSPECTIVE— THE PROBLEM OF MULTIPLE DIRECTORSHIPS AND INTERLOCKING DIRECTORATES IN EARLY AMERICAN CORPORATE JURISPRUDENCE

Unfortunately, a dearth of case law exists on the subject of the duties of dual directors. However, as far back as the beginning of the Industrial Revolution and the early days of American corporate jurisprudence, courts recognized the problems inherent in interlocking directorates.[2] An "interlocking directorate" occurs when two companies share one or more common directors, thus producing a potential conflict in contractual and other relations between the companies.[3] Case law has produced several conflicting trends over the past century with respect to interlocking directorates and multiple directorships.

In *Metropolitan Elevated Railway Co. v. Manhattan Elevated Railway Co.*,[4] a New York court elucidated the nineteenth century proposition that contracts between two corporations with antagonistic interests and common directors were voidable regardless of the fairness or unfairness of the transaction.[5] According to the New York Court of Appeals in *Munson v. Syracuse Geneva & Corning Railroad Co.*,[6] the law

> does not stop to inquire whether the contract or transaction [is] fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction, or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question or abstract justice in the

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2. *See, e.g.*, Metropolitan Elevated Ry. Co. v. Manhattan Elevated Ry. Co., 1884 WL 10786, at *1 (N.Y. Sup. Ct. Apr. 1884) (holding that fairness is not part of the determination of whether individuals acting within an interlocking directorate have a conflict of interest).

3. 15 U.S.C.A. § 19 (West 1998).

4. 1884 WL 10786, at *1.

5. *Id.* at *65, *69; Skinner, *supra* note 1, at 93.

6. 8 N.E. 355, 355 (N.Y. 1886).

particular case.[7]

Thus, in the formative days of American corporate law, the mere fact that a director sat on more than one board could have voided the contracts between the two corporations on whose boards he sat. *Munson* is an example of how, during the late nineteenth century, courts took the concept of a director's fiduciary duties to his corporation and its shareholders quite seriously. Such a strict construction of the law, which obviously disfavored multiple directorships, likely led to only a small number of individuals serving on more than one corporate board.

By the beginning of the twentieth century, however, courts relaxed the rule so that a contract between two corporations having a shared or common director "was valid if it was approved by a disinterested majority" of the directors and was not found to be unfair.[8] Thus in *Hines v. C.A. Hiles & Co.*,[9] "the court upheld a contract between two corporations having only one common director on the ground that the contract" was fair.[10] According to the court, "[w]here, as we have found in this case, the contract was a fair one, the court will sustain it, even though one of the directors was common to both corporations."[11] In addition, the United States Supreme Court in 1921 held that

> [t]he relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness . . . .[12]

Courts relaxed the rules pertaining to dual directors as the corporate form became more and more common for business entities. Such a phenomenon led to an inevitable problem of supply and demand. An increase in the number of corporations in the United States, and a corresponding increase in the number of corporate boards of directors, led to a decrease in the number of qualified director candidates.[13] Simply put, the more American corporations flourished, the more problems those corporations had in finding qualified candidates to serve on their boards. Thus, more and more of the qualified corporate directors commenced service on more than one board, leading to an increase in both the

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7. *Id.* at 358. *See* Skinner, *supra* note 1, at 93 (discussing the holding of *Munson*).

8. Skinner, *supra* note 1, at 93-94.

9. 120 Ill. App. 617 (1905).

10. Skinner, *supra* note 1, at 94.

11. *Hines*, 120 Ill. App. at 625.

12. Geddes v. Anaconda Mining Co., 254 U.S. 590, 599 (1921).

13. *See* Skinner, *supra* note 1, at 75 (arguing that interlocking directorates lead to a scarcity of competent management for corporations).

potential for conflicts of interest and questions pertaining to the fiduciary duties of dual directors. Such a problem still exists in this country today, evidenced by a study of the modern case law from Delaware and other states.

II. MODERN CASE LAW— A TREND TOWARDS AN INCREASED NUMBER OF MULTIPLE DIRECTORSHIPS AND LESS EMPHASIS ON THE FIDUCIARY DUTIES OF MULTIPLE DIRECTORS

By the middle of the twentieth century, when relatively few individuals were deemed qualified to serve on corporate boards, many directors began to serve on an increased number of boards.[14] Today, at the beginning of a new century, individuals commonly serve on three, four, or five corporate boards. Even service on six or seven boards is not unheard of. Amazingly, some individuals ("professional" directors) manage to sit (and serve) on as many as ten to twelve corporate boards.[15] This trend has led to an increase in the number of conflicts between corporations that share common directors and the interested shareholders of these corporations.

A. *Development of the Modern Case Law in Delaware: 1966-1983*

Modern Delaware case law addressed the parent-subsidiary relationship/dual directorship problem.[16] Delaware courts have held that dual directors have fiduciary duties where there is an overlap of the board of directors of the parent and the subsidiary corporations.[17] According to the Delaware Supreme Court in *Warshaw v. Calhoun*,[18] dual directors of parent and subsidiary corporations "owe the same duty of good management to both corporations . . . [that] is to be exercised in light of what is best for both corporations."[19]

Warshaw involved a breach of fiduciary duty lawsuit brought by a minority shareholder of a subsidiary against several of the subsidiary's directors who were also directors of the parent corporation.[20] According to the court, "several of the individual defendants here are the directors of both Securities and Casualty [the parent and subsidiary corporations]."[21] Therefore, the court

14. Richard H. Koppes, Address At Georgia State University College of Law, Atlanta, Ga. (Apr. 5,1999).

15. *Id.*

16. E. Norman Veazy et al., *Counseling Directors on the Business Judgment Rule and the Duty of Loyalty*, 731 PLI/CORP. 475, 537 (1991).

17. *Id.*

18. 221 A.2d 487, 487 (Del. 1966).

19. *Id.* at 492.

20. *Id.* at 491-92.

21. *Id.* at 489.

held that

> [with respect to] Securities and Casualty, the directors who operated in a dual capacity owed Casualty the duty to see that the issuance of its stock should be upon terms best for Casualty. Similarly, the directors of Securities were charged with the duty of determining what was best for Securities. . . . On the record before us, we think that these directors acted with this standard in mind.[22]

Not long after *Warshaw*, the Delaware Supreme Court stated in *Levien v. Sinclair Oil Corp.*,[23]

> [a]s to directors, dual and multiple directorships are permissible and a person who is a director of a parent and of a subsidiary owes the same duty of good management to both, but this does not mean that an additional directorship is a device for diluting fiduciary duties. If it were, that would be, to state it mildly, a turnabout under our law.[24]

In 1967, the Chancery Court of Delaware held in *Meyerson v. El Paso Natural Gas Co.* that the directors of a parent corporation have a fiduciary duty to treat fairly the minority stockholders of a subsidiary corporation.[25] In *Meyerson*, a minority shareholder of Northwest Production Company ("Northwest"), a subsidiary of El Paso Natural Gas Company ("El Paso"), brought a derivative action claiming that El Paso had been unjustly enriched at the expense of Northwest by taking advantage of Northwest's tax losses.[26]

The El Paso officers and directors who utilized the tax scheme to El Paso's advantage were also directors and/or officers of Northwest.[27] The plaintiff shareholders alleged that El Paso, "by reason of its stock ownership of Northwest and the duality of management was and is a fiduciary charged with the duty of treating the subsidiary and its minority shareholders fairly."[28] As such, the plaintiffs alleged that El Paso "breached its duty by retaining for itself all dollar benefits resulting from the inclusion of the tax losses of Northwest in [El Paso's] consolidated federal income tax returns."[29]

El Paso conceded that in this situation it owed fiduciary

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22. *Id.* at 492.

23. 261 A.2d 911 (Del. 1969).

24. *Id.* at 915.

25. 246 A.2d 789, 794 (Del. Ch. 1967).

26. *Id.* at 789-90. As an owner of more than 80% of the stock of Northwest, El Paso was qualified under the Internal Revenue Code to file consolidated tax returns. *Id.* For the tax years 1962-1965, consolidated tax returns were filed, and tax losses of Northwest were used to offset El Paso's taxable income, resulting in "substantial" tax savings to El Paso. *Id.* at 790.

27. *Id.*

28. *Id.* at 790.

29. *Id.*

duties to Northwest.[30] However, according to the Chancery Court,

> the nature and extent of fiduciary duty depend upon the circumstances and the relationship of the parties in each case. Where the problem concerns duty of majority stockholders to the minority, or more specifically, as here, parent corporation to minority stockholders of its subsidiary, "the basic question is almost always one of fact: Were the minority stockholders treated fairly?"[31]

The court analyzed the tax situation to determine whether the minority shareholders had been treated fairly. Quoting *Western Pacific Railroad Corp. v. Western Pacific Railroad Co.*, the *Meyerson* court stated that

> the dual officers owed fiduciary duties to both corporations to promote the interests of both and to obtain for each what it was entitled to under the tax laws. Under this state of facts these officers had a positive duty to make use of the loss as they did, that is, to offset the income . . . with deductible losses. If the positions were reversed and the subsidiary had a loss and the parent had income, the officers would have been obliged to file consolidated returns to enable the corporation to make use of the loss.[32]

According to the *Meyerson* court,

> [t]he *Western* case stands for the proposition that the retention of tax savings by a profit-subsidiary resulting from the filing of consolidated income tax returns is not unfair as to the loss-parent even where the circumstances disclose dual management and the domination of the parent by the subsidiary with the resulting fiduciary duties.[33]

The court also looked to *Case v. New York Central Railroad Co.*[34] for guidance.[35] Quoting *Case*, the *Meyerson* court reiterated "the inevitable fact that there cannot be effective bargaining among affiliates."[36] Accordingly, when the parties to a bargain are not disinterested, "it must be the rule that anything short of gross and palpable overreaching does not warrant court interference."[37] Taking *Western* and *Case* into consideration, the court found that the minority stockholders of Northwest had been treated fairly and that the officers and directors of El Paso, who were also officers and directors of Northwest, had not breached any fiduciary

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30. *Meyerson*, 246 A.2d at 790.
31. *See id.* (quoting Abelow v. Midstates Oil Corp., 189 A.2d 675, 680 (Del. Ch. 1962)).
32. *See id.* at 791 (quoting *Western Pac. R.R. Corp.*, 197 F.2d 994, 1001 (9th Cir. 1951)).
33. *Id.* at 792.
34. 243 N.Y.S.2d 620, 620 (N.Y. App. Div. 1962).
35. *Meyerson*, 246 A.2d at 792.
36. *See id.* at 792 (quoting *Case*, 243 N.Y.S.2d at 623).
37. *Id.*

duties owed to the minority shareholders.[38]

Meyerson established that dual officers and directors owe fiduciary duties to the shareholders of both corporations, yet they will not be held liable for a breach of those duties unless some sort of "gross overreaching" occurs.[39] Such actions will be measured under a test of fairness, and the holding suggests that so long as the officers' and directors' actions are "fair," no breach of fiduciary duty will be found.[40]

Four years after *Meyerson*, the Delaware Supreme Court addressed the fairness issue in *Sinclair Oil Corp. v. Levien*.[41] *Sinclair* was a derivative action filed on behalf of Sinclair Venezuelan Oil Co. ("Sinven"), a subsidiary of Sinclair Oil Corp. ("Sinclair"), against Sinclair for a breach of fiduciary duty.[42] Sinven alleged that Sinclair, which owned 97% of Sinven, caused Sinven to pay excessive dividends in excess of earnings, thus effectively making Sinven "a corporation in dissolution."[43] The officers and directors of Sinven were officers, directors or employees of corporations in the Sinclair complex.[44] The court below found that the directors had no independent identity separate from Sinclair, and thus owed Sinven a fiduciary duty.[45] The question before the court then was, what was the proper test to apply to transactions that involved parent and subsidiary corporations with similar or identical officers and boards?[46]

Because of Sinclair's fiduciary duty and its control over Sinven, the Chancellor held that Sinclair's relationship with Sinven must meet the intrinsic fairness test.[47] Under this objective standard, Sinclair was required to prove that its transactions with Sinven were fair.[48]

Sinclair argued that the proper standard to apply in such situations was the business judgment rule.[49] The court disagreed, holding that in a situation between a parent and a subsidiary, with the parent controlling the transaction and fixing the terms, the intrinsic fairness test, with its resulting shifting of the burden

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38. *Id.* at 792-93.
39. *Id.* at 792.
40. *Meyerson*, 246 A.2d at 792.
41. 280 A.2d 717 (Del. 1971).
42. *Id.* at 719.
43. *Id.* at 720.
44. *Id.* at 719.
45. *Id.* at 719. The court below held that Sinclair's relationship with Sinven would have to meet the test of intrinsic fairness. *Id.*
46. *Sinclair*, 280 A.2d at 719-20.
47. *Id.*
48. *Id.* at 720.
49. *See id.* (arguing that under the business judgment rule, the court should not be allowed to interfere with the judgment of the board of directors, unless there is a showing of "gross and palpable overreaching").

of proof, must be applied.[50] What is critical, the court stated, is a situation where the parent corporation "has received a benefit to the exclusion and at the expense of the subsidiary."[51] The court continued,

> [a] parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, this alone will not invoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing—the situation when a parent is on both sides of a transaction with its subsidiary. Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.[52]

To illustrate the proper use of the intrinsic fairness test, the *Sinclair* court posed the following hypothetical.

> Suppose a parent dominates a subsidiary and its board of directors. The subsidiary has outstanding two classes of stock, X and Y. Class X is owned by the parent and Class Y is owned by the minority stockholders of the subsidiary. If the subsidiary, at the direction of the parent, declares a dividend on its Class X stock only, this might well be self-dealing by the parent. It would be receiving something from the subsidiary to the exclusion of and detrimental to its minority stockholders. This self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard by which to evaluate the dividend payments.[53]

The court analyzed the Sinclair-Sinven dividend transaction and determined that Sinclair had not engaged in self-dealing.[54] Thus, the business judgment rule, not the intrinsic fairness test, was the proper rule to apply to the facts of the case.[55]

The Delaware Supreme Court reaffirmed this principle in 1983 in deciding *Weinberger v. UOP, Inc.*[56] In *Weinberger*, the court stated that "there is no dilution of [the fiduciary] obligation where one holds dual or multiple directorships, as in the parent-subsidiary context. Thus . . . this duty is to be exercised in light of what is best for both companies."[57]

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50. *Id.*
51. *Sinclair*, 280 A.2d at 720.
52. *Id.*
53. *Id.* at 721.
54. *Id.* at 722.
55. *Id.*
56. 457 A.2d 701, 703 (Del. 1983).
57. *Id.* at 710-11.

B. Anadarko Petroleum Corp. v. Panhandle Eastern Corp.: The Delaware Supreme Court Chips Away at the Fiduciary Duties Owed by Multiple Directors

While dual and multiple directors in the parent-subsidiary context owe both companies the same duty of good management, the Delaware Supreme Court in 1988 in *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*[58] held that a parent owes no fiduciary duty to its wholly-owned subsidiary.[59] Specifically, the court held that directors of a parent corporation owed no fiduciary duty to the prospective shareholders of a wholly-owned subsidiary during a period when the parent was negotiating a stock dividend spin-off of the subsidiary.[60]

Panhandle Eastern ("Panhandle") owned Anadarko Petroleum ("Anadarko") as a wholly-owned subsidiary.[61] Panhandle decided to spin off Anadarko by offering a stock dividend to Panhandle shareholders.[62] Following the approval of the stock dividend, but prior to the date of distribution, Panhandle and the Anadarko board of directors restructured several contracts between the two companies, resulting in agreements with terms much more favorable to Panhandle than Anadarko.[63] After the spin-off, Anadarko brought suit against its former parent and three of its own former directors, alleging that the restructured contracts were unfair to Anadarko.[64] The plaintiffs in *Anadarko* argued that the Anadarko directors and the parent corporation violated a fiduciary duty to the prospective shareholders of Anadarko by approving the disputed contracts.[65]

The court found that the dispute "present[ed] a novel issue[, specifically,] whether a corporate parent and directors of a wholly-owned subsidiary owe fiduciary duties to the prospective stockholders of the subsidiary after the parent declares its intention to spin-off the subsidiary."[66] Upon deliberation, the court found that no duty existed.[67] The Anadarko board members who approved the contract modifications and were sued individually were R.D. Hunsucker, R.L. O'Shields and R.C. Dixon.[68] Mr. Hunsucker, in addition to serving as a director of Anadarko, was

58. 545 A.2d 1171 (Del. 1988).
59. *Id.* at 1174.
60. *Id.*
61. *Id.* at 1173.
62. *Id.*
63. *Anadarko*, 545 A.2d at 1173.
64. *Id.* at 1172.
65. *Id.*
66. *Id.*
67. *See id.* (holding that interests held by Anadarko's prospective shareholders prior to distribution were insufficient to impose fiduciary obligations on parent and subsidiary directors).
68. *Anadarko*, 545 A.2d at 1174 n.1.

Panhandle's president and chief executive officer.[69] Mr. O'Shields served as an Anadarko director and as chairman of the Panhandle board of directors.[70] Mr. Dixon, in addition to his duties on the Anadarko board, served as an officer and director of two additional Panhandle subsidiaries.[71] The directors alleged that, in their capacity as directors of Anadarko, they owed no fiduciary duty to the prospective shareholders of that corporation and that they were required merely to act in the best interest of the parent corporation.[72] The Delaware Supreme Court agreed.[73]

The court noted that Anadarko attacked the terms of the disputed agreements based on the claim that the agreements were drafted adversely to Anadarko's interests by entities under a fiduciary obligation to Anadarko's prospective shareholders.[74] The court acknowledged a basic principle of Delaware general corporate law requiring directors to practice the fundamental fiduciary duties of loyalty and disinterestedness.[75] More specifically, directors may only stand on one side of a transaction, and may not derive any personal benefit through self-dealing.[76]

However, the court noted that in Delaware, "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[77] Thus, individuals who serve as directors of both the parent and the wholly-owned subsidiary do not owe a fiduciary duty to the subsidiary, but are charged only with acting in the best interest of the parent and its shareholders.

According to the court, the converse is also true: a parent (and by implication, its directors) "does[/do] not owe a fiduciary duty to its [/their] subsidiary."[78] However, Anadarko attempted to subvert this principle by arguing that Panhandle's "actions relating to the spin-off... established a class of stockholders" to whom Panhandle and the Anadarko board owed a fiduciary duty.[79] Anadarko contended that "by setting a record date for the dividend distribution and by establishing a market for Anadarko shares,"

69. *Id.*

70. *Id.*

71. *Id.* at 1173. A fourth director, Robert L. Allison, served on the boards of both Anadarko and Panhandle, but voted against the contract modifications and was thus not subject to the lawsuit. *Id.* Subsequent to the approval of the contracts, the three inside directors who had approved the agreements resigned and were replaced. *Id.* at 1173-74.

72. *Id.* at 1176.

73. *Anadarko*, 545 A.2d at 1177.

74. *Id.* at 1174.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Anadarko*, 545 A.2d at 1174.

79. *Id.*

Panhandle and the Anadarko board created a fiduciary relationship with the prospective shareholders.[80] The court disagreed and refused to find that a fiduciary relationship had been formed.[81] According to the court, the setting of a record date for the dividend distribution and "the existence of a stock ledger containing the names of Panhandle's stockholders . . . who had an expectation of becoming Anadarko shareholders at a future specified date, does not provide a valid basis to impose fiduciary duties on Panhandle and Anadarko's former directors."[82] In addition, while "a distinct interest was created by providing a market for Anadarko stock prior to distribution . . . [that] interest does not rise to the level of a beneficial interest for purposes of imposing fiduciary duties on Panhandle and Anadarko's former directors."[83]

Thus, the inside directors of Anadarko, those who served as directors of Panhandle as well as Anadarko, owed no fiduciary duty to the prospective shareholders of Anadarko. When wearing the hats of both corporations, the inside directors could favor the interests of one corporation over the other and did not have to abstain from voting on issues which seemingly presented a conflict of interest. Though directors of Anadarko, they were entitled to act in the best interests of Panhandle, even when the interests of the two conflicted, without violating any affirmative duties to Anadarko. The court stated that in such a context, "the directors of the subsidiary are obligated to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[84]

On Motion for Rehearing in *Anadarko*, the Delaware Supreme Court reaffirmed its holding while limiting its ruling to the Delaware corporate law claim asserting that a fiduciary duty was present between the board of directors and its prospective stockholders before the date of the expected shares.[85] According to the court, the relevant inquiry is twofold: "to whom is the fiduciary duty owed and at what time."[86]

Ten years after *Anadarko*, the Chancery Court of Delaware faced a similar question with differing facts. As the following discussion indicates, the Delaware courts may have, within the past ten years, reached a turning point with respect to the treatment of the fiduciary duties of individuals with multiple directorships.

80. *Id.*
81. *Id.* at 1177.
82. *Id.* at 1175.
83. *Anadarko*, 545 A.2d at 1176.
84. *Id.* at 1174.
85. *Id.* at 1178.
86. *Id.*

III. *SHAEV V. WYLY:* A NEW HOPE FOR SHAREHOLDERS OF CORPORATIONS WITH INTERLOCKING DIRECTORATES?

In 1998, the Delaware courts considered *Shaev v. Wyly*,[87] a case that presented facts quite similar to those of *Anadarko*, with a slight variation. In *Shaev*, Plaintiff David Shaev brought a derivative action suit against Sterling Software, Inc. ("Software").[88] Shaev was a shareholder of Software, the parent company, and Sterling Commerce, Inc. ("Commerce"), formerly Software's wholly-owned subsidiary which Software spun-off through a stock dividend in 1996.[89] The plaintiff alleged that several months prior to the spin-off, the subsidiary's directors, in anticipation of the spin-off, "granted themselves options on 9,000,000 shares of Commerce stock."[90] On the same day, the directors of the parent corporation, at least four of whom were also directors of the subsidiary, approved the stock option plan as well.[91] The plaintiff claimed that this stock option created an excessive windfall to the defendant directors, and that the grant of the stock options violated the defendants' fiduciary duty to the prospective shareholders of the subsidiary corporation because the options would have extracted hundreds of millions of dollars from Commerce.[92] Shaev filed a derivative action on Commerce's behalf, arguing that the defendants "breached their fiduciary duty of loyalty by granting themselves excessive compensation."[93] The plaintiff further noted that most of these defendants had one, if not multiple, other full-time positions, and could not have reasonably devoted the necessary time and effort to the Commerce business.[94]

Shaev's complaint is insightful, for it offers a glimpse at the nature of the problems presented by multiple directorships. In his complaint, Shaev alleged the following regarding the individuals serving in multiple directorships.

> 7. Defendant Sam Wyly, in addition to being a director of Commerce, is also a member and the chairman of the board of directors of Software. He is also an executive officer of Software. . . . He is also a member and chairman of the board of directors of Michaels Stores, Inc. ("Mike"). . . . He is also an executive officer of Mike. . . . Mike has had substantial losses during the last two years, a fact that will preoccupy all its officers and directors and require a great deal of their time. He is also a partner in Maverick Capital,

87. No. 15559-NC, 1998 WL 13858, at *1 (Del. Ch. Jan. 6, 1998).
88. *Id.* at *1.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Shaev*, 1998 WL 13858, at *1.
93. *Id.*
94. *Id.*

> Ltd., an investment fund management company. So, he has three full time jobs, in addition to his directorship at Commerce.[95]
>
> 8. Defendant Charles J. Wyly, Jr., a brother of defendant Sam Wyly, in addition to being a director of Commerce, is also a member and the vice chairman of the board of directors of Software. He is also an executive officer of Software. . . . He is also a member and the vice chairman of the board of directors of Mike. He is also an executive officer of Mike. . . . He has two full time jobs in addition to his directorship at Commerce.[96]
>
> 13. Defendant Robert E. Cook is a member of the Commerce board of directors. He is also chairman of the board of Roadshow International, Inc. . . . and is an officer of Pitchfork Development, Inc. . . .[97]

As a result of the duties and responsibilities of the defendant directors, Shaev alleged as follows:

> 17. Defendants . . . cannot devote and cannot reasonably be expected to devote full time, attention and service to the business of Commerce. As alleged above, most of them have two or three other full time jobs. Moreover, those other jobs are their primary occupations.[98]
>
> 18. Following the spin-off of Commerce by Software, those two companies maintained significant contractual and other ongoing relationships that can and will produce conflicts of interest for a majority of the Commerce board of directors. . . .[99]
>
> 20. These conflicts could require a resolution whereby defendants Sam Wyly, Charles J. Wyly, Jr., Evan A Wyly, and Sterling L. Williams have no choice but to refrain from participating in discussions and board action on behalf of Commerce.[100]
>
> 21. Moreover, the actual and potential conflicts of interest that are continuously faced by defendants . . . make them unable to act totally in the best interests of Commerce.[101]

The defendant directors moved for summary judgment alleging that, at the time of the option plan, a fiduciary duty was owed to Software and its shareholders because Commerce remained a subsidiary.[102] Although Shaev was a Software shareholder at the time the directors granted the options, he failed

95. Plaintiff's Complaint ¶ 7, *Shaev v. Wyly*, No. 15559-NC, 1998 WL 13858 (Del. Ch. Jan. 6, 1998).
96. *Id.* ¶ 8.
97. *Id.* ¶ 13.
98. *Id.* ¶ 17.
99. *Id.* ¶ 18.
100. Plaintiff's Complaint ¶ 20, *Shaev*, 1998 WL 13858.
101. *Id.* ¶ 21.
102. *Shaev*, 1998 WL 13858, at *1.

to bring suit double-derivatively under Delaware law prior to the spin-off;[103] thus, the defendants argued that the plaintiff's only recourse was as a prospective shareholder of Commerce.[104] The defendants moved for summary judgment, arguing that they owed no fiduciary duty to prospective shareholders because, under the reasoning of *Anadarko*, a fiduciary duty does not arise between the directors of a wholly-owned subsidiary and post-spin-off stockholders until after the spin-off is complete.[105]

The chancery court, however, stated that although *Anadarko* established the general foundation of fiduciary duty between parents and wholly-owned subsidiaries, the particular issue addressed in *Anadarko* was not at issue in *Shaev*.[106] The *Shaev* court stated that *Anadarko* did not address all aspects of the present case and was not dispositive as to its results.[107] The court distinguished *Anadarko* because in that case, the plaintiff shareholders had alleged that the directors of the subsidiary had violated a fiduciary duty to prospective shareholders of the subsidiary, whereas in the present case, the plaintiff made no such allegation.[108] Shaev did "not claim that Commerce's directors owed him a duty as a prospective Commerce shareholder."[109] According to the court, "this case is different from *Anadarko* because at the time of the alleged breach of fiduciary duty, the spin-off was not advanced, nor probably even contemplated."[110]

According to the court, at the time the Commerce board granted itself stock options, there were no "prospective Commerce Shareholders" because the spin-off had not yet been contemplated.[111] "Commerce owed fiduciary duties only to Software and Software's shareholders."[112] Before the spin-off, Shaev could have filed a double derivative suit on behalf of

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103. *See* DEL. CODE ANN. tit. 8, § 327 (Supp. 1998) (stating that "in any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was stockholder of the corporation at the time of the transaction of which he complains or that his stock devolved upon him by operation of law.")

104. *Shaev*, 1998 WL 13858, at *1.

105. *Id.* at *1.

106. *Id.* at *3.

107. *Id.* at *2, *3.

108. *See id.* at *3 (discussing the plaintiff's claim that fiduciary duty was breached while the plaintiff was a current shareholder). *See also* Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1172 (Del. 1988) (discussing Anadarko's claim that a fiduciary duty was owed to the subsidiary).

109. *Shaev*, 1998 WL 13858, at *3.

110. *Id.*

111. *Id.*

112. *See id.* at *3 (following the principle stated in *Anadarko*, 545 A.2d at 1172, that directors of the subsidiary corporation have only a fiduciary duty to the parent corporation and its stockholders).

Commerce under Delaware law.[113] However, for reasons not addressed in the court's opinion, Shaev failed to do so. Because Shaev did not file a double derivative action when he had the opportunity, and because he did not become a Commerce shareholder until after the incident in question, the defendant directors argued that Shaev lacked standing to bring suit, either derivatively or double derivatively.[114] The chancery court, however, allowed the suit to proceed.[115] The court held that, where the facts are so compelling, to allow the defendants to be shielded from liability because of a standing issue would allow the defendants to escape potential liability for misdeeds.[116] The court examined the public policy behind Section 327 of the *Delaware Code*[117] and reasoned that the very purpose of Section 327 would be undermined if the plaintiff were denied standing to sue.[118] The court continued to distinguish *Anadarko*:

> *Anadarko*'s holding, that under the circumstances of that case, the parent corporation did not assume fiduciary duties with respect to a class of prospective shareholders the parent created by its own actions, has no applicability to the present case, where plaintiff seeks relief for alleged wrongs that occurred when plaintiff could not have been a prospective shareholder because the impending spin-off had not been announced and may not even have been contemplated.[119]

After distinguishing *Anadarko*, the court held that "Software's decision to divest itself of its entire interest in Commerce cannot, as a matter of law, deprive plaintiff of standing to bring a derivative action on behalf of Commerce, even where the challenged actions occurred before plaintiff owned shares in Commerce."[120] The court then allowed Shaev to proceed with a derivative action alleging a breach of fiduciary duty against the inside directors of Commerce.[121] On October 1, 1998, the Delaware Supreme Court affirmed the decision of the chancery court,

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113. *Id.*
114. *Shaev*, 1998 WL 13858, at *3.
115. *Id.*
116. *Id.* at *4.
117. *See* DEL. CODE. ANN., tit. 8, § 327 (Supp. 1998) (providing guidance to a plaintiff in a stockholder's derivative action).
118. *See Shaev*, 1998 WL 13858, at *4 n.19, stating:

> [t]he sole purpose of section 327 is to prevent what has been considered an evil, namely, the purchasing of shares in order to maintain a derivative action designed to attack a transaction which occurred prior to the purchase of the stock... [however,] [p]laintiff here did not purchase shares in Commerce to bring suit for actions taken before he was a shareholder.

119. *Id.*
120. *Id.* at *5.
121. *Id.*

allowing the lawsuit to proceed.[122] In doing so, the court may have signaled the beginning of a new era in corporate governance with respect to multiple directorships. Although the fact that the Commerce directors served in multiple directorships was collateral to the primary issue of excess compensation, the Delaware courts, by allowing David Shaev's suit to go forward, afforded him the opportunity to show that the directors of Sterling Software, individuals who served in many and varied capacities as officers and directors of several corporations, breached fiduciary duties to him and his fellow shareholders by virtue of the very nature of their multiple directorships. Such a finding of liability would be unprecedented, given the scarcity of case law on the subject of multiple directorships and the relative nonchalance with which courts have usually treated the issue. It would, of course, represent a major turning point in judicial treatment of the fiduciary duties of corporate directors.[123]

IV. THE MODERN TREND IN CORPORATE GOVERNANCE: FEWER DIRECTORSHIPS

Such a trend is not as dramatic as it seems. Over the past decade, a trend towards better corporate governance has emerged on the American corporate landscape. Led by institutional investors and shareholder activists, the movement towards more responsible, more responsive corporate boards has produced a number of developments that may signal an end to the days of widespread multiple directorships.

Throughout much of the last quarter century, corporate directors who served on more than one corporate board have been relatively invincible in defending claims against angry shareholders, as evidenced by the *Sinclair* and *Anadarko* decisions. Multiple directorships were common and stood as a symbol of power and prestige. However, as a new century dawns, the trend towards multiple directorships seems to be falling into disfavor with many in the corporate community. In 1996, the Teamsters union issued a list of "America's Least Valuable Directors."[124] An important consideration for the Teamsters in assessing the candidates and the qualities that rendered them "least valuable" was the number of corporate boards on which the

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122. *Wyly v. Shaev*, No. 155, 1998 WL 764168, at *1 (Del. Oct. 1, 1998).

123. Such a result, unfortunately, was not the outcome of the *Shaev* case. The parties settled the case in the summer of 1999, thus bringing a premature end to the litigation. Telephone Interview with Norman M. Monhait, Attorney for David Shaev (Apr. 16, 1999).

124. *See* INTERNATIONAL BHD. OF TEAMSTERS, AMERICA'S LEAST VALUABLE DIRECTORS: A STUDY OF CORPORATE BOARD DIRECTORS (Spring 1996) (providing a list of directors serving multiple corporations) (on file with the International Bhd. of Teamsters).

directors sat.[125] The Teamsters deemed service on too many boards to be a hindrance to strong director performance.[126] Predictably, the least valuable directors on the Teamsters' list had all served in multiple directorships.[127]

That same year, the National Association of Corporate Directors (NACD) issued its Report on Director Professionalism.[128] This report stresses many of the same issues as the Teamsters' report, including the inherent evils of multiple directorships.[129] Additionally, in 1998, at the same time the Delaware courts were considering *Shaev v. Wyly*, Richard H. Koppes, former general counsel to the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the country and a leader in the corporate governance movement, addressed a convention of corporate general counsels and enunciated several factors to improve corporate governance with emphasis on director performance.[130] Mr. Koppes suggested that general counsels should "encourage board members to spend more quality time on their directorship with an eye toward less board memberships."[131]

Such a trend should continue into the next decade. To date, no corporate officer or director has ever been found by a court of law to have violated a fiduciary duty to the shareholders of a corporation simply by serving on more than one board. However, as the *Shaev* case illustrates, the possibility exists for such a situation to occur in the future. As shareholders become more and more active in corporate governance, and as the decade-long trend towards better corporate governance continues, individuals who serve on more than one corporate board may face increasing hostility from shareholders alleging that those individuals have either stretched themselves too thin or have created an irreparable conflict of interest. While liability for such a breach of fiduciary duty may have seemed unheard of just several years ago, it is no longer such a novel concept.

V. MR. SMITH'S DILEMMA REVISITED

In the hypothetical situation addressed at the beginning of this Article, our fictitious friend Mr. Smith was concerned about a

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125. *Id.*

126. *Id.*

127. *Id.*

128. *See* John A. Byrne, *Listen Up: The National Association of Corporate Directors' New Guidelines Won't Tolerate Inattentive, Passive, Uninformed Board Members*, BUS. WK., Nov. 25, 1996 at 100 (discussing the NACD's new guidelines).

129. *Id.*

130. Richard H. Koppes, Corporate Governance in Today's Capital Markets, Address Before The Association of General Counsel of Cleveland, Ohio (Oct. 9, 1998).

131. *Id.*

number of conflicts presented by his service to more than one corporation. This Article has addressed the state of the law with respect to the fiduciary duties of individuals with multiple directorships. Armed with this knowledge, now is an appropriate time to answer some of the questions that Mr. Smith's dilemma posed.

First, Mr. Smith was concerned about the nature of his relationship with B Corp. once that corporation was formed as a subsidiary of A Corp. As *Anadarko* makes clear, when B Corp. was a wholly-owned subsidiary of A Corp., Mr. Smith owed no fiduciary duty to the subsidiary. However, when A Corp. sold a small interest in B Corp. to minority investors, Mr. Smith's relationship changed slightly. From the holdings of *Sinclair*[132] and *Weinberger*,[133] one can see that Mr. Smith had the duty of "good management,"[134] and was charged with exercising his fiduciary duties based on the best interests of both companies.[135] Once B Corp. was completely spun off from A Corp., so that A Corp. no longer owned any interest in B Corp., Mr. Smith presumably had an obligation of good management to both corporations. If a potential for conflict arose between the two companies—for example, a contentious contract negotiation—Mr. Smith would have had a duty of fairness to both corporations. Accordingly, Mr. Smith might have best served the interests of both corporations by recusing himself from the transaction.

Second, Mr. Smith was concerned about the demands on his time created by his service as CEO of two corporations. As a fiduciary of both, Mr. Smith wondered for which entity he should spend the majority of his time working. Unfortunately, no clear answer to this question can be gleaned from a study of the case law addressed in this Article. However, Mr. Smith still owes the duty of good management to both corporations and must exercise his discretion in light of what is best for both companies. Such a standard might be helpful to the corporate officer or director in deciding how best to allocate his or her time. However, the standard does little to warn such an individual when he might be violating his fiduciary duty to one corporation by devoting too much time to the other. Surely, "good management" is a concept that may be (and apparently is, according to the courts) open to quite a bit of interpretation.

Had the *Shaev* case continued in litigation, rather than

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132. *See Levien v. Sinclair Oil Corp*, 261 A.2d 911, 915 (Del. 1969) *rev'd in part on other grounds*, 280 A.2d 717 (Del. 1971) (holding that directors of a parent and subsidiary corporation owe a duty of good management to both).

133. *See Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) (holding that in the parent-subsidiary context, a director of both owes a duty of good management to both).

134. *Sinclair*, 261 A.2d at 915.

135. *Weinberger*, 457 A.2d at 711.

ending in settlement, the final outcome in that case might have been different. Such a decision would have likely been helpful in determining whether the devotion of too much time to one corporation hinders an individual's ability to fulfill his or her duties to another corporation, thus resulting in legal liability. If the Delaware courts had taken a bold step and held the officers and directors of Sterling Software liable for breach of fiduciary duty for stretching themselves too thin, ample guidance and a stern warning would be given to the hundreds of corporate officers and directors who, like Mr. Smith, serve in multiple capacities with more than one corporation.

Regarding the conflict of interest problems posed by Mr. Smith, clearly his service in multiple directorships will not preclude him from serving on more than one board. However, the duty of good management would require him to recuse himself from any transaction or decision between the corporations that he serves if his participation in those transactions or decisions would lead to a conflict of interest. By simply removing himself from a potential conflict situation, Mr. Smith would not compromise his ability to act in the best interest of both corporations.

Finally, Mr. Smith was concerned about the additional directorship he assumed with C Corp., which brought his total number of directorships to three. As is clear from the current trend towards better corporate governance, Mr. Smith would be wise to decline future invitations to serve on additional boards and to concentrate his full attention on the corporations that he currently serves. While there is no magic number of corporate boards on which an individual may sit, it would be ill-advised given the current corporate climate for Mr. Smith to stretch himself and his talents too thin. A final resolution to the issues presented in the *Shaev* case would have been helpful in this regard if the Delaware courts had been presented with the opportunity to give some indication of the legal liabilities of serving in multiple directorships. If the courts had found that the directors in that case breached their fiduciary duty to Mr. Shaev by spending too much time focusing their attention on other corporations, such a ruling would clearly have given Mr. Smith notice that service on any additional boards would not be wise.[136]

CONCLUSION

Over the past century, the multiple directorship pendulum has swung back and forth from contempt to acceptance and back again. At the beginning of the Industrial Revolution, multiple directorships were discouraged, and contracts between

136. Again, such a finding is unlikely at present, as the parties have entered into settlement negotiations. Thus, the chances of the Delaware courts adjudicating such an issue, at least in this case, are remote.

corporations with common or shared directors could be voided. For most of this century, however, multiple directorships have been common, as a limited number of individuals has been deemed qualified to serve on the boards of an ever-increasing number of American corporations. Now, however, the trend towards multiple directorships seems to have shifted again.

The past decade has seen great changes in the American corporate landscape. Shareholders and institutional investors have become more interested in the management of the corporations in which they have invested and which they own. While it was once common for individuals to serve in multiple directorships, or to serve as officers of more than one corporation, such a trend seems to have reached its peak. More and more corporate watchdogs call for directors to limit the number of boards on which they serve.

As the case law from the Delaware courts indicates, no director or officer has ever been held liable for serving in too many corporate capacities. Although such a finding of liability may not come for several years at the very least, the groundwork has been laid, as evidenced by the *Shaev* complaint, for such a holding at some point in time in the future.

As the twenty-first century dawns, shareholders are becoming more and more active. They are becoming increasingly aware of the obligations, commitments and duties of the directors and officers who serve them. In the process, the liabilities of multiple directorships become painfully obvious. Two of these liabilities include the potential for conflicts of interest and the potential for violation of the fiduciary duties of loyalty and care. Of these potential pitfalls, our fictitious friend Mr. Smith should be well aware.