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The Meaning of the "Corporate Constituency" Provision of the Illinois Business Corporation Act

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I. INTRODUCTION

During the height of corporate takeover activity in the mid-1980's, the Illinois legislature added section 8.85, a so-called "corporate constituency" provision, to the Illinois Business Corporation Act ("BCA"). Section 8.85 allows corporate directors and officers, "when considering the best short-term and long-term interests of the corporation," to consider the effects of any action upon employees, suppliers, customers, local communities, and other pertinent factors. Over half of the states have adopted similar corporate constituency statutes.
The corporate takeover battles of the 1980's left extensive case law in their wake. Courts analyzed both the common law duties of corporate directors when corporate control is at stake and the various antitakeover statutes enacted by the states. Corporate constituency statutes, however, though widely adopted, have never been subjected to comparable judicial scrutiny. In light of the current resurgence in merger and acquisition activity, this Article examines the meaning of section 8.85 and considers what impact, if any, it has on the legal duties owed by directors and officers of Illinois corporations.

This Article first examines the historical development of corporate constituency statutes, including the rise and fall of the shareholder wealth maximization theory of fiduciary duties. The Article then discusses and analyzes section 8.85, Illinois' corporate constituency statute, focusing on the statute's rejection of the shareholder primacy theory. Next, the Article discusses the new challenges for corporate directors posed by the statute, and the changes the statute brings to Illinois corporate law. Finally, the Article concludes by observing that section 8.85, though widely viewed as an antitakeover device, actually clarifies years of conflicting judicial decisions by adopting an "entity" theory of the corporation.


6. See statutes cited supra note 3.


8. See infra part II.

9. See infra part II.A.

10. See infra part II.B.

11. See infra part III.

12. See infra part IV.A.

13. See infra parts IV.B. and IV.C.

14. See infra part V.
II. THE HISTORICAL DEVELOPMENT OF ILLINOIS' CORPORATE CONSTITUENCY STATUTE

Illinois law prior to the enactment of Section 8.85 did not clearly define the parties to whom corporate directors owed a fiduciary duty. Most Illinois courts held that directors owed a fiduciary duty to both the corporation and to the corporation's shareholders. This definition of a corporate director's fiduciary duties is rife with contradiction. A frequently quoted statement captures the internal conflict inherent in what was the prevailing Illinois approach:

The directors of a corporation are trustees of its business and property for the collective body of stockholders in respect to such business . . . . It is their duty to administer the corporate affairs for the common benefit of all stockholders and exercise their best care, skill, and judgment in the management of the corporate business solely in the interest of the corporation.

The hostile takeover activities of the 1980's graphically exposed the problem with this formulation. When fundamental corporate issues are at stake, particularly control over the corporation, the "common benefit of all stockholders" and the "best interests of the corporation" may diverge sharply. Hostile takeovers were commonly viewed as pitting the shareholder's short-term interests in profit maximization against the best long-term interests of the corporation. The corpo-

15. Throughout this article, "directors" includes both corporate officers and directors. Section 8.85 is a somewhat unusual corporate constituency statute in that it expressly applies to corporate officers as well as directors. ILL. COMP. STAT. ANN. ch. 805, § 5/8.85 (stating that the statute applies to "the board of directors, committees of the board, individual directors, and individual officers . . . .").


18. See David Millon, Redefining Corporate Law, 24 IND. L. REV. 223, 242 (1991) (stating that "[t]he hostile takeover explosion fractured the complacently assumed unity of interest between the corporate entity and shareholders.").

19. Id. Discussing the inherent ambiguity in defining the board's duty to "the corporation and its shareholders," Delaware Chancellor William Allen stated:

[T]his particular phrase masks the most fundamental issue: to what interest does the board look in resolving conflicts between interests in the corporation that may be characterized as "shareholder long-term interests" or "corporate entity interests" or "multi-constituency interests" on the one hand, and interests that may be characterized as "shareholder short-term interests" or "current share value interests" on the other?

ration's long-term interests include the interests of labor, creditors, suppliers, and other local community "constituents" integral to the success of the corporation. Illinois law, which imposed a fiduciary duty on directors to both the shareholders and the corporation, provided no effective guidance in this situation and, indeed, posed a major problem.

A. The Shareholder Wealth Maximization Theory of Fiduciary Duties

One suggested solution to the dual standard problem, which gained substantial academic support, posits shareholder wealth maximization as the primary duty of the directors. This "shareholder primacy" approach is based on a recognition that shareholders are in a fundamentally different position than other corporate constituents. Constituents such as employees, creditors, and suppliers contractually secure for themselves a fixed return and a degree of protection from the corporation's opportunistic behavior. Shareholders, in contrast, are only "residual claimants" to the corporation's profits.

Basing their arguments on the principle of shareholder wealth maximization, advocates of shareholder primacy argue that shareholders need the protection of fiduciary duties. Such duties lower the agency costs associated with opportunistic behavior by those who control the corporation. Fiduciary duties owed by directors to

20. See generally John C. Coffee, Jr., Shareholders Versus Managers: The Strain in the Corporate Web, 85 MICH. L. REV. 1 (1986) (discussing the conflicting interests present in the corporate structure). Commentators who favor an open market for corporate control concede that the short-term impact of a corporate takeover on some corporate constituents can be very hard. See, e.g., Jonathan R. Macey, Externalities, Firm-Specific Capital Investments and the Legal Treatment of Fundamental Corporate Changes, 1989 DUKE L. J. 173 (noting that fundamental corporate changes such as mergers, hostile takeovers and plant closings disrupt the lives of everyone connected with the affected corporation). A short-term perspective may be the only relevant perspective for many low-wage workers with limited savings.


22. See Millon, supra note 18, at 227-33 (providing a historical overview of shareholder primacy approach).

23. See Millon, supra note 18, at 227-33.

24. See Millon, supra note 18, at 227-33.

25. See generally Frank Easterbrook & Daniel Fischel, The Corporate Contract, 89 COLUM. L. REV. 1416, 1447 (1989) (arguing that investors and managers can align their interests to achieve a common goal). An earlier theoretical justification for the
shareholders function, in effect, as a de facto contract, supplied by state corporate law, for the benefit of the shareholders.\textsuperscript{26}

At the same time that the shareholder primacy argument gained substantial academic support, the market for corporate control boomed as hostile takeover activity reached unprecedented heights.\textsuperscript{27} Strong opposition to the high levels of takeover activity developed based on the perception that "bust up" corporate takeovers created harmful effects on employees, local communities, bondholders and other corporate constituents.\textsuperscript{28} Critics of takeover activity contended that a substantial portion of the "control premiums" paid to shareholders in a takeover represented an unfair expropriation of wealth from other corporate constituents. For instance, critics pointed to bondholders who faced increased credit risks because of new debt incurred to finance takeovers and to employees who lost their jobs as a result of "downsizing" in the wake of takeovers.\textsuperscript{29}

\textbf{B. Courts and Legislatures Reject the Shareholder Primacy Approach}

Heeding the criticism levied against the high level of takeover activity, courts rejected the theory of shareholder wealth maximization, except in limited circumstances where the breakup or sale of the com-

\begin{itemize}
  \item principle of shareholder primacy is to view the relationship between management and shareholders as a trust relationship, with management acting as trustees of the shareholders' property, i.e., the corporation. See A. Berle, \textit{Corporate Powers as Powers in Trust}, 44 HARV. L. REV. 1049 (1931). Many Illinois cases from earlier this century relied upon the trust analogy when discussing the duties owed by directors. See, e.g., \textit{Dixmool}, 156 N.E. at 787-88.
  \item See Millon, \textit{supra} note 18.
\end{itemize}
pany was "inevitable." Courts made clear that directors could consider the impact of a takeover on constituencies other than shareholders. Directors were allowed to consider creditors, customers, employees, and even the community. In addition, courts permitted directors to establish antitakeover devices such as the poison pill. Courts also allowed directors to rely on long-term corporate plans or the protection of special cultural features of the corporation to thwart a takeover transaction clearly favored by a majority of the shareholders.

Unfortunately, courts never satisfactorily resolved the debate concerning to whom directors owe their primary fiduciary duty. Some decisions continued to subordinate the interests of non-shareholder constituents to shareholder wealth maximization, while other decisions permitted consideration of interests other than the shareholders.

30. See Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d at 182; see also Paramount Communications Inc. v. QVC Network, Inc., 637 A.2d at 43 (stating that a sale of control imposes a special obligation on directors to act reasonably so as to seek the transaction offering the best value available to the stockholders). As the Delaware Supreme Court stressed: "absent a limited set of circumstances as defined under Revlon, a board of directors, while always required to act in an informed manner, is not under any per se duty to maximize shareholder value in the short term, even in the context of a takeover." Paramount Communications, Inc. v. Time, Inc., 571 A.2d at 1150; see also Lawrence A. Cunningham & Charles M. Yablon, Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?), 49 Bus. Law. 1593 (1994) (analyzing Delaware fiduciary law and discussing the significance of the modern trend toward a unified concept of fiduciary law).


32. See Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351-53 (Del. 1985). A poison pill is defined as "a defensive tactic used by a company that is a target of an unwanted takeover to make its shares or financial condition less attractive to an acquirer." BLACK'S LAW DICTIONARY 71 (6th ed. 1990).

33. Time, 571 A.2d at 1154.

34. Compare Revlon, 506 A.2d at 176 (recognizing the propriety of the board's consideration of non-shareholder interest, but stating that some rationally related benefit must accrue to the stockholders) with Unocal, 493 A.2d at 955 (allowing board to consider non-shareholder interests in determining whether takeover bid is in best interest of the corporate enterprise, without explicitly requiring board to find that shareholders are thereby benefited).
Largely at the prompting of the incumbent management of sizable local companies fearing hostile takeovers, \(^{35}\) state legislatures enacted a formidable arsenal of antitakeover laws. \(^{36}\) Corporate constituency statutes typically were rushed through state legislatures as part of these antitakeover legislation packages. \(^{37}\) In addition to antitakeover provisions, \(^{38}\) the various constituency statutes have four other common features: (1) the statutes allow—but generally do not require—directors to consider the interests of constituents other than shareholders; (2) the statutes reject the shareholder wealth maximization approach and instead focus director duties on serving the best interests of the corporation; (3) the statutes apply both in calm times and when corporate control is at stake; and (4) the statutes do not expressly vest the corporate constituents (the purported beneficiaries of the statutes) with any legally enforceable rights. \(^{39}\)

III. \textbf{THE ILLINOIS CORPORATE CONSTITUENCY STATUTE: A REJECTION OF THE SHAREHOLDER PRIMACY APPROACH IN ILLINOIS}

In 1985, Illinois adopted section 8.85 of the BCA, a corporate constituency provision, as part of an antitakeover legislation package. \(^{40}\) Section 8.85 reads as follows:

\textbf{DISCHARGE OF DUTIES—CONSIDERATION.—} In discharging the duties of their respective positions, the board of directors, committees of the board, individual directors and individual officers may, in considering the best long term and

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38. Section 8.85, Illinois' corporate constituency statute, was similarly enacted as part of antitakeover legislation. \textit{See} Kaplan, \textit{supra} note 37.

39. \textit{See supra} note 3 for a list of the various corporate constituency statutes.

40. \textit{See} Kaplan, \textit{supra} note 37.
short term interests of the corporation, consider the effects of any action (including without limitation, action which may involve or relate to a change or potential change in control of the corporation) upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors.41

Section 8.85, like the majority of case law42 and the various state antitakeover laws,43 rejects the shareholder primacy approach. Instead, section 8.85 establishes that the primary duty of directors is to act in the “best interests of the corporation.” Despite its genesis as an antitakeover device,44 section 8.85’s importance, thus, extends far beyond the takeover arena.

As a result of section 8.85, directors are not legally bound to treat shareholder interests superior to the interests of the other corporate constituents.45 On its face, section 8.85 establishes that the directors of Illinois corporations owe a primary duty to the corporation.46 The primary duty directors owe to the corporation supersedes any duty owed to any particular corporate constituency, including shareholders.47 Thus, section 8.85 begins with the premise that directors and officers “discharg[e] the duties of their respective positions . . . [by] considering the best long term and short term interests of the corporation.”48

42. See supra notes 30-34 and accompanying text.
43. See supra notes 35-39 and accompanying text.
47. Id.; see supra note 41 and accompanying text.
A. The Historical Roots of Section 8.85 Evidence An Intent to Reject the Shareholder Primacy Theory

The historical circumstances surrounding the statute's adoption in 1985 indicate that section 8.85 is best characterized as a decisive and intentional rejection of the view that corporate law requires directors to treat shareholder wealth maximization as their primary duty. Section 8.85 allows directors, in promoting the best interests of the corporation, to give substantial consideration to the interests of non-shareholder constituents beyond that mandated by the contracts with those constituents.

Examination of the law in Illinois prior to the enactment of section 8.85 sheds light on the purpose of the provision. Before the adoption of section 8.85, Illinois law allowed directors to focus on the best interests of the corporate enterprise by considering the interests of non-shareholder constituencies and adopting a long-term perspective. In other words, Illinois law already allowed directors to consider non-shareholder interests using a long-term perspective within a framework in which the directors are to serve the "best interests of the corporation and the stockholders." Thus, if all section 8.85 did was to codify the existing common law rules, it was hardly necessary. Presumably, the drafters intended section 8.85 to do more.

Section 8.85 does, in fact, do more. By attempting to resolve an inherent conflict between the best interests of the shareholders and the best interests of the corporation, section 8.85 substantially changes Illinois corporate law. Section 8.85 establishes that the director's primary fiduciary duty is to the corporate entity. This, in turn, reduces

49. See Kaplan, supra note 37, at 374-77.

50. ILL. COMP. STAT. ANN. ch. 805, § 5/8.85 (West 1995) (advising that directors should consider the effects of any action "upon employees, suppliers, and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located . . . ").

51. See Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968). In Shlensky, the court affirmed the dismissal of a shareholder suit challenging the owner's failure to install lights at Wrigley Field. Id. The owner opposed the installation of lights because in his opinion baseball was a daytime sport and he believed that night baseball games would cause the surrounding neighborhood to deteriorate. Id. at 778. The shareholder plaintiff alleged that the team could have earned more money if lights were installed. Id. at 777. The court concluded that the directors' consideration of the impact of night baseball games on the neighborhood was proper because neighborhood quality related to the "long run interest of the corporation" in attracting patrons and preserving the value of the Wrigley Field property. Id. at 780.

52. Id. at 780.

53. See supra notes 15-20 and accompanying text for a discussion of the conflict involved.

54. See supra notes 40-48 and accompanying text.
the status of shareholders to a position of one among a set of corporate constituents.\textsuperscript{55} In order to dispel any doubts, however, section 8.85 might be amended to add shareholders to the list of corporate constituents whose interests the directors may consider in performing their primary duty to act in the corporation's best interests.\textsuperscript{56}

By establishing the best interests of the corporate enterprise as the primary duty of corporate directors, section 8.85 marks an important development in Illinois corporate law. In prior years, Illinois courts made a variety of often conflicting statements to describe the duties owed by directors. One formulation, consistent with section 8.85, proposed: "[i]t is the duty of directors to manage the corporate business solely in the interest of the corporation."\textsuperscript{57} Another formulation, defining the scope of fiduciary duties much more broadly, opined: "[t]he relation of directors of a corporation to its stockholders, towards the corporation, and in many instances towards its creditors, is a fiduciary relationship."\textsuperscript{58} The most popular formulation in Illinois case law, however, suggested that directors and officers owe a fiduciary duty to the corporation \textit{and} to the shareholders.\textsuperscript{59}

\textsuperscript{55} See supra note 31 and accompanying text for a discussion of the constituent interests a director may consider.

\textsuperscript{56} See infra notes 68-70 and accompanying text for a discussion of the statute's failure to mention shareholders. The Indiana corporate constituency statute, for example, provides that the "directors are not required to consider the effects of a proposed corporate action on any particular corporate constituent group or interest as a dominant or controlling factor." \textsc{Ind. Code Ann.} § 23-1-35-1(f) (West 1995). The Indiana statute also expressly includes shareholders as corporate constituents. \textsc{Ind. Code Ann.} § 23-1-35-1(d) (West 1995). See also \textsc{Pa. Cons. Stat.} § 1515 (1995) (including shareholders as corporate constituents, although directors are not required to regard any corporate interest as dominant or controlling).

The Iowa corporate constituency statute states explicitly that shareholders do not occupy a preferred position among the corporate constituents:

[c]onsideration of any or all of the community interest factors [e.g., interests of corporate constituencies] is not a violation of the business judgment rule or of any duty of the director to the shareholders, or a group of shareholders, even if the director reasonably determines that a community interest factor or factors outweigh the financial or other benefits to the corporation or a shareholder or group of shareholders.

\textsc{Iowa Code Ann.} § 491.101B(2) (West 1995). See infra notes 70-72 and accompanying text.


\textsuperscript{58} Winger v. Chicago City Bank & Trust Co., 67 N.E.2d 265, 275 (Ill. 1946) (citations omitted).

\textsuperscript{59} See cases cited supra notes 16-17.
Section 8.85, if given full effect, should put an end to the latent ambiguity that currently exists in Illinois case law with respect to the duties owed by directors. Under section 8.85, directors owe a primary duty to the “corporation,” not to any particular corporate constituent. Likewise, directors can consider any “pertinent” interest of any corporate constituent in discharging their duty to act in the best long-term interests of the corporation. Section 8.85 relieves directors of the legal responsibility to place the interests of shareholders above those of the other corporate constituents.

B. The Language of Section 8.85 Indicates a Legislative Intent to Reject the Shareholder Primacy Approach

The Illinois General Assembly carefully drafted section 8.85 ensuring that it consists of both mandatory and permissive components. The statute requires directors and officers to consider the best interests of the corporation in discharging their duties. In considering the best interests of the corporation, however, the statute allows directors and officers to consider (or not to consider) the interests of the various corporate constituents. In other words, section 8.85 does not require the directors to take into account the interests of any particular corporate constituency. Rather, the statute permits directors to consider a wide range of interests so that the directors can fulfill their overriding duty to define and pursue the best interests of the corporation.

60. See supra notes 56-58 and accompanying text.
61. ILL. COMP. STAT. ANN. ch. 805, § 5/8.85 (West 1995); see supra notes 41-48 and accompanying text.
62. Id.; see supra note 41 and accompanying text.
63. The statute provides: “In discharging the duties of their respective positions . . . [officers and directors] may . . . consider the effects of any action (including without limitation, action which may involve or relate to a change or potential change in control of the corporation) upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors.” ILL. COMP. STAT. ANN. ch. 805, § 5/8.85 (West 1995) (emphasis added). The emphasized language indicates the prime directive imposed by all officers and directors by § 8.85.
64. The statute provides:

“In discharging the duties of their respective positions . . . [officers and directors] may . . . consider the effects of any action (including without limitation, action which may involve or relate to a change or potential change in control of the corporation) upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors.”


65. Only Connecticut requires directors to consider the interests of non-shareholder constituents. See CONN. GEN. STAT. ANN. § 33-313(e) (West 1995) (stating that “a director... shall consider... (3) the interests of the corporation’s employees, customer, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located.”).
The language in section 8.85 instructing directors to consider the best “long term” interests of the corporation provides another clear signal that section 8.85 subordinates shareholder interests to those of the corporate entity. For instance, the statute supports a board of directors rejection of a takeover bid that would give shareholders a sizable, immediate premium on the ground that the long-term interests of the corporation would be better served if no change in control occurred. Indeed, section 8.85’s use of the language “long-term interests” can reasonably be read as a legislative preference for the interests of the corporation as a whole, as defined by incumbent management, over the interests of shareholders or any other corporate constituent.

Equally as important as what the statute contains is what the statute omits: the statute fails to mention shareholders. Shareholders are not even included as one of the constituents whose interests the directors may consider. The statute’s omission of any reference to shareholders is significant and surely no accident. Presumably, the exclusion of shareholders from the text of section 8.85 was intended to underscore the fact that section 8.85 rejects the principle of shareholder primacy in Illinois corporate law.

66. See, e.g., Time, 571 A.2d at 1148 (accepting the board’s belief that long-term synergistic benefits and preservation of “Time Culture” justified rejection of an attractive all-cash bid); QVC, 637 A.2d at 41 (rejecting takeover bid because Paramount board believed transaction favored by incumbent management provided more advantageous business prospects for the corporation).

67. Those who oppose hostile takeovers often claim that they are furthering the best long-term interests of the corporation. See e.g., Time, 571 A. 2d at 1148. See generally Martin Lipton and Steven A. Rosenblum, A New System of Corporate Governance: The Quinquennial Election of Directors, 58 U. CHI. L. REV. 187, 205-13 (1991). Indeed, the Illinois General Assembly’s addition of the “long-term interests” language to § 8.85 in 1989 can plausibly be read as a signal of its support for the notion that the interest of the corporate enterprise, as defined by incumbent management, should be of paramount importance to directors in discharging their fiduciary duties.

68. Puzzlingly, § 8.85, unlike many corporate constituency statutes, also omits creditors from the list of constituents whose interests the directors are expressly authorized to consider. Cf. IOWA CODE ANN. § 491.101 B(1)(a) (West 1995) (authorizing directors to consider effects of takeover bid on “creditors” and other constituents). The failure to list creditors as one of the § 8.85 corporate constituents does not cause the same interpretative problems as does the exclusion of shareholders. Historically, the debate over the corporate directors’ fiduciary duties has not been centered around creditors. Courts to date have rebuffed efforts to increase the scope of the fiduciary duties owed by directors to include creditors. See, e.g., Metropolitan Life Ins. Co. v. RJR Nabisco, 716 F. Supp. 1504 (S.D.N.Y. 1989). Creditors are owed fiduciary duties in special circumstances associated with the insolvency of the corporation. See infra note 100 and accompanying text. For arguments that the corporate law should give greater protection to creditors see Bratton, supra note 29; Morey W. McDaniel, Bondholders and Stockholders, 13 J. CORP. L. 205, 265-312 (1988).

69. See supra note 41 and accompanying text.
Unfortunately, the General Assembly’s failure to mention shareholders in section 8.85, though possibly meant to underscore an important clarification in Illinois corporate law, potentially causes mischief. For example, a fair argument can be made that, by omitting shareholders from section 8.85’s list of corporate constituents, the General Assembly intended to retain both the traditional privileged position of shareholders vis-à-vis other corporate constituents and the notion that directors continue to owe the same fiduciary duties to the corporation as its shareholders. This narrow reading of section 8.85, however, though theoretically plausible, is not well supported.

As described above, corporate constituency statutes were adopted to rebuff a powerful legal doctrine equating the fiduciary duties of corporate directors with shareholder wealth maximization. Interpreting section 8.85’s silence with respect to shareholders as protecting the prerogatives of the shareholders conflicts with the historical roots of corporate constituency statutes.

Furthermore, section 8.85 ties the primary duty of the directors to the best interests of the corporation. Had the General Assembly intended only to codify the then prevailing common law rule that directors owe a fiduciary duty to both the corporation and its shareholders, section 8.85 would have been drafted differently to provide that in considering the best interests of the corporation and its shareholders the directors may consider the impact on other constituents. Thus, the absence of shareholders from the language of section 8.85 is entirely consistent with the view that section 8.85 is intended to modify the common law rule by establishing that the directors owe a primary fiduciary duty to the corporation alone.

70. Many other corporate constituency statutes also omit shareholders from the list of constituents, which has prompted some commentators to conclude that constituency statutes represent no more than the “confirm[ation of] what the common law has been: directors may take into account the interests of other constituencies but only as and to the extent that the directors are acting in the best interests, long as well as short term, of the shareholders and the corporation.” ABA COMMITTEE ON CORPORATE LAWS, OTHER CONSTITUENCIES STATUTES: POTENTIAL FOR CONFUSION, 45 BUS. LAW. 2253, 2269 (1990); see also Charles Hansen, Other Constituency Statutes: A Search for Perspective, 46 BUS. LAW. 1355, 1375 (1991) (concluding that statutes concerning non-shareholder constituents should be seen as a codification of the common law for each state). Other commentators vehemently disagree with this view of corporate constituency statutes. See, e.g., Millon, supra note 18, at 256-57.

71. See supra notes 30-39 and accompanying text, and see supra part III.A.

72. See supra notes 15-17 and accompanying text for a discussion of the prior view that directors owed a common fiduciary duty to the corporation and the shareholders.
C. Section 8.85 Is Consistent With American Corporate Law Traditions

At first glance, section 8.85, like other corporate constituency statutes, appears to offend fundamental principles of corporate law by eliminating shareholder primacy. The notion of shareholder wealth maximization is a long-standing principle deeply ingrained in American corporate law. Courts have long observed that

[a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among shareholders in order to devote them to other purposes.

Upon closer examination, however, section 8.85 represents a much less radical shift in corporate law than may first appear. Over the past two hundred years, the prevailing conception of the nature and purpose of the corporation and, thus, of the nature of the duties owed by corporate directors has changed dramatically. The notion that the directors' primary duty is to act on behalf of the interests of the shareholders—the putative "owners" of the corporation—represents but one approach. Over time, the law developed alternatives to this approach.

A convincing alternative to the shareholder primacy approach views the corporation as an entity vested with its own rights and interests. Under this "entity theory," the interests of the various corporate constituents, including shareholders, are subordinated to the greater good of the corporate entity. Corporate directors and officers owe their primary duty to the corporation and not to the shareholders per se. As discussed above, section 8.85 represents a rejection of the

73. ROBERT CLARK, CORPORATE LAW § 16.2 (1986).
75. See generally, David Millon, Theories of the Corporation, 1990 DUKE L. J. 205-23. (discussing how theories of the corporation have developed and changed over the last one hundred and fifty years).
77. Id. at 211-20. Another approach to understanding the corporation that held sway in the first half of the 1800's was to view the primary duty of the corporation as serving the public interest. Id. at 207. This view prevailed at a time when the states granted narrow charters to corporations to perform some public function; it has little contemporary relevance, when state corporation statutes place few restrictions on the business activities of corporations. See, e.g., ILL. COMP. STAT. ANN. ch. 805, § 5/3.05 (1992) (allowing corporations to be organized for any lawful purpose); see also Steven M.H. Wallman, The Proper Interpretation of Corporate Constituency Statutes and
shareholder primacy approach in favor of the entity approach.

IV. NEW CHALLENGES FOR DIRECTORS OF ILLINOIS CORPORATIONS: DEFINING THE BEST INTERESTS OF THE CORPORATION

While section 8.85 clarifies an important aspect of Illinois corporate law, it also creates new ambiguities and challenges. Section 8.85 poses a difficult challenge to directors of Illinois corporations. The statute fails to define the best interests of a reified entity like the "corporation" because the law neither supplies a single fiduciary duty standard—such as shareholder wealth maximization—nor specifies a corporate constituency whose interests the directors are to treat as preeminent.

A. The Scope of Discretion Section 8.85 Vests in Corporate Directors: Broad but not Unbridled

Prior to the enactment of section 8.85, directors could use shareholder wealth maximization as a surrogate for the best interests of the corporation, at least when corporate control was not at stake. Although section 8.85 does not require directors to deviate from the profit maximization norm, it certainly allows directors to deviate from that practice. It appears that the General Assembly intended that section 8.85 would encourage directors to view the scope of their fiduciary duties more broadly, to consider the interests of non-shareholder constituents, and to act in the best long-term interests of the corporation. Significantly, section 8.85 does not even mention shareholders as a constituent whose interests may be considered.

Section 8.85 allows directors to define the corporate mission much more broadly than under prior law. For example, section 8.85 may allow a board of directors to substitute a business strategy designed to maximize the economic return realized by the corporation's constituents as a whole, in effect replacing a strategy designed to maximize

Formulation of Director Duties, 21 STETSON L. REV. 163 (1991) (arguing that corporate constituency statutes are consistent with well-established corporate law norms).

78. See supra notes 40-72 and accompanying text.

79. The common law formulation that directors owe a fiduciary duty to the corporation and its shareholders encouraged this identity of interests.

80. See generally Stephen M. Bainbridge, Interpreting Nonshareholder Constituency Statutes, 19 PEPP. L. REV. 971 (1992) (arguing that non-shareholder constituents as well as shareholders deserve their share of the corporate benefits).

81. See supra notes 68-72 and accompanying text for a discussion of the significance of this omission.
corporate profits. Section 8.85 would appear to shield such a broad strategy from challenge even if the shareholder returns are reduced as a result of the strategy. Presumably, section 8.85 would also allow directors to define the best interests of the corporation by maximizing the economic and non-economic returns to the various corporate constituents.\footnote{Examples of non-monetary returns include the tangible and psychic benefits from stable work relationships, work safety measures above those required by law, flexible work hours, measures designed to support employees who are parents, and extra efforts to recruit employees from disadvantaged communities. The list of possibilities is endless. See Lewis D. Solomon, On the Frontier of Capitalism: An Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment, 50.2 WASH. & LEE L. REV. 1625 (1993).}

Although section 8.85 grants directors broad discretion in defining the best interests of the corporation, such discretion is not absolute. Other provisions of the BCA,\footnote{See, e.g., ILL. COMP. STAT. ANN. ch. 805, § 5/1.01 (West 1995).} as well as common law restraints on director power,\footnote{See 13 ILLINOIS LAW AND PRACTICE, Corporations, §§ 321-358 (1955 & Supp. 1994) (summarizing Illinois common law restraints on actions by corporate directors).} impose limitations on the discretion of corporate directors. Section 12.50(b) of the BCA,\footnote{ILL. COMP. STAT. ANN. ch. 805, § 5/12.50(b) (West 1992).} for example, allows a court to order dissolution of the corporation, or invoke certain alternative remedies,\footnote{ILL. COMP. STAT. ANN. ch. 805, § 5/12.55 lists the alternatives to dissolution: court appointment of a receiver or custodian or a court-supervised buyout of the complaining shareholder's stock. The Illinois Legislature recently passed legislation overhauling §§ 12.50-12.65 of the BCA. Among other things, the legislation expands the list of remedies which may be invoked by close corporation shareholders who are “oppressed” by those in control of the corporation. See IL Senate Bill 433.} when a shareholder demonstrates that those in control of the corporation are engaged in fraud, corporate waste or “oppression” of shareholders.\footnote{ILL. COMP. STAT. ANN. ch. 805, § 5/12.50(b) (West 1992). The common law prohibition against corporate waste is also a check on any abuses of § 8.85. See Saxe v. Brady, 184 A.2d 602 (Del. Ch. 1962).}

Reconciling section 8.85 with the common law and statutory prohibitions against oppression of shareholders will be an interesting task if the directors of Illinois corporations aggressively utilize section 8.85 to pursue corporate goals that, however laudable and beneficial to the corporate enterprise, do not promote shareholder wealth maximization.\footnote{It is important to note, however, that the “oppression” remedy never figured in any significant way in the corporate takeover cases over the last decade.} Unfortunately, case law does not provide guidance on the interplay between section 8.85 and the shareholder’s remedy against “oppression.”\footnote{The statutory remedy protecting shareholders against oppression is closely
Such lack of judicial guidance leaves several important questions unanswered which, in turn, creates ambiguities and uncertainties for corporate directors. For example, would it constitute shareholder oppression for a company to slash dividends to zero in order to preserve the jobs of employees if a shareholder could prove that the company was heavily overstaffed relative to its competitors? What if, in such a case, the directors could make a colorable showing that they reasonably believed that promoting stable long-term employment relationships was in the best long-term interests of the corporation? Likewise, is it a “waste” of corporate assets to pursue corporate goals of, for example, standards of product quality well over what the market demands, above-market pay and benefit levels for lower-level employees, or unusually high levels of corporate philanthropy?

Market forces provide the strongest restraints on the discretion of corporate directors. The legal latitude that section 8.85 gives directors in defining the best interests of the corporation does not magically insulate the corporation from market forces which demand a high degree of fealty to the goal of profit maximization. For lenders and trade creditors, a corporate board’s interest in promoting “stable long-term relationships,” or its glowing vision of a bright long-term corporate future, is no substitute for a business that generates sufficient cash flow to service its debts. Shareholders also get restive if the company fails to generate a competitive rate of return.

A publicly traded company that generates a relatively low rate of return experiences low demand for its stock and other securities, raising the company’s cost of capital and weakening its competitive status. In many industries, global competitive forces in the product market compel a business which hopes to survive to make difficult decisions—including layoffs, plant closings and the like—which have an immediate negative impact upon non-shareholder constituencies. Thus, the international market for corporate control, to the extent it is not stifled by corporate constituency provisions, state antitakeover statutes and other deterrents such as “poison pills,” operates to displace incumbent management that fails to realize the full profit potential


90. Especially in this period of intense international competition and extensive “downsizing,” corporate management is accustomed to articulating why the best interests of the corporation require actions that have an adverse effect on various corporate constituents. Thus, having directors define the corporation’s best long-term interests in a legal regime where shareholders are no longer primary is not an impossible task for directors.
from corporate assets.91

The corporate structure of most Illinois corporations provides additional protection from unbridled director discretion. The vast majority of Illinois corporations function as so-called "close corporations."92 Close corporations typically consist of a few shareholders who operate and control the business.93 In many close corporations, the shareholders are also simultaneously the "other constituents" by holding positions as employees, creditors and suppliers.94 Thus, the structure of most Illinois corporations promotes a rough identity of interest between the shareholders and the other corporate constituents, ensuring that profit generation will remain of key importance.

B. Section 8.85 In Action: How the Corporate Constituency Statute May Alter Corporate Practice

Critics of constituency statutes argue that making directors primarily accountable to something as amorphous as the "corporation" and allowing directors to define the corporation's best interests creates a risk of opportunistic and inefficient behavior.95 One hopeful response to such criticism is that a broader view of the corporation as a web of interdependent relationships that needs to be carefully nurtured is needed in order for American businesses to increase their long-term competitiveness.96

Corporate constituency statutes provide a legal environment that arguably will strengthen the American corporation for the rigors of global competition by fostering directors' consideration of a broad range of interests using a long-term perspective in order to best develop the corporate enterprise.97 Moreover, the market constraints

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91. See Easterbrook & Fischel, supra note 21.
94. See, e.g. Amsted Indus. Inc. v. Pollack Indus., 382 N.E.2d 393 (Ill. App. Ct. 1978) (discussing that sole shareholder of corporation was also one of the corporation's creditors).
97. See Mark J. Roe, Some Differences in Corporate Structure in Germany, Japan and
on corporations make it unlikely that corporate constituency statutes will either prescribe "economic folly," or cover the systematic looting of corporations by insiders. Thus, in most situations, directors will find that the best interests of the shareholders, as residual claimants to the corporation’s cash flow, and the best interests of the "corporation" as a whole will be allied.

Section 8.85 may come into play, however, in two situations where shareholder interests often diverge from those of other constituents. First, even before Illinois enacted section 8.85, the law recognized that when a corporation approaches insolvency, shareholder interests must yield to those of the corporation’s creditors. Prior to insolvency, shareholders have little to lose and much to gain if the corporation embarks on a risky business strategy that may resuscitate the troubled corporation. On the other hand, risky business endeavors more often than not will deplete assets which could have gone to the creditors in the event of bankruptcy and thus operate contrary to the best interests of the creditors. Therefore, when a corporation nears insolvency, directors become trustees for the creditors.

Section 8.85 is innovative in that it allows directors to follow the same strategy whether or not the corporation approaches insolvency. In other words, section 8.85 allows directors, under the rubric of the "best interests of the corporation," to tailor the company’s business strategy to maximize the expected return for all corporate constituents, rather than just the shareholders. As a result, marginal companies not yet on the brink of insolvency may undertake a more


98. See supra part II.A for a discussion of market constraints as well as other limitations on director discretion.


101. See ILL. COMP. STAT. ANN. ch. 805, § 5/8.85 (West 1995). The statute does not facially distinguish between insolvent and solvent situations. Id.
conservative short-term business strategy. However, for most companies, market forces likely will demand close attention to shareholder wealth maximization and, thus, preclude changes in business strategy.

Section 8.85 may also come into play when corporate control is at stake. Section 8.85, consistent with the Unocal approach, allows directors and officers to consider a wide range of interests when responding to a takeover bid. The more difficult question remains whether section 8.85 impacts on the so-called Revlon duties, which requires directors and officers to pursue shareholder wealth maximization when a change in corporate control is inevitable.

Delaware, the home of the Unocal and Revlon decisions, does not have a corporate constituency statute, and the limited case law from other jurisdictions sheds little light on the question. Certainly, in many situations, directors will have legitimate grounds for believing that selling or liquidating the company furthers the best interests of the corporation and its various constituents. Section 8.85 should have no effect on such a determination.

What about the situation in which such a sale or liquidation does not necessarily advance the best interests of the corporation or its constituents? According to Revlon, once the directors decide to sell or liquidate the corporation, few grounds, if any, exist for considering the interests of corporate constituents because the corporation ceases to be

102. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1989) (stating that corporate directors may consider non-shareholder interests when protecting the corporate enterprise from harm stemming from a hostile takeover). See supra notes 31 and 34 and accompanying text for a discussion of this approach.

103. Ill. Comp. Stat. Ann. ch. 805, § 8.85 (West 1995). The statute allows the directors to consider the interests of, among others, employees, customers, and communities in which the corporation is located. Id.

104. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (discussing the duty of a board of directors to maximize a company's value when faced with the corporation's breakup). See supra notes 30 and 34 and accompanying text for a discussion of these duties.


106. Situations in which directors may reasonably conclude that continued independence is not in the best interest of the corporation are too numerous to list comprehensively. Common situations include where a company realizes that it lacks the capital or other resources to compete in a changing market, the absence of a strong successor after the founder of a family-owned business retires, or the presence of a bidder who offers an attractive price and the promise that the existing corporate constituents will have a continuing role in the new enterprise.
ongoing. Section 8.85 may modify the Revlon duties by allowing directors to consider the best interests of the corporation at every step of the auction process.

Under section 8.85, directors might conclude that the sale of the company to the highest bidder would be so injurious to one or more corporate constituents that the best interests of the corporation requires selling the company to another bidder, who promises better treatment for the constituents after the sale. This might occur, for example, when the sale of the corporation to the highest bidder would have such a significant negative impact on a corporate constituent that the directors conclude that the sale fails to comport with the corporation's long-followed standards for the treatment of the corporate constituents. Section 8.85 similarly would allow directors to reject takeover bids which they believe would, if accepted, likely lead to the insolvency of the company.

In sum, contrary to the views of one early interpreter, section 8.85 does not significantly change the common law duties of directors when corporate control is at stake. Section 8.85 only allows directors to avoid mechanical application of the Revlon shareholder wealth maximization rule.

C. Enforcing Section 8.85: Who May Bring Suit Alleging a Violation of the Corporate Constituency Statute?

Many commentators have argued that corporate constituency statutes do not vest non-shareholder constituents with standing to sue either to force directors to fully and fairly take into account their interests or to recover damages if the directors fail to adequately consider their interests. Section 8.85 gives no indication of being an exception; it

107. Revlon, 506 A.2d at 182 ("Concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.").

108. Of course, directors who fail to act with a requisite degree of care in evaluating a takeover bid, or who feign concern about a corporate constituent in order to thwart a takeover bid, or who favor a bid promising lucrative side payments to incumbent management still face liability for breach of a fiduciary duty to the shareholders. See Cede & Co. v. Technicolor, Inc., 634 A.2d 345, modified, 636 A.2d 956 (Del. 1993); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).


110. See Kaplan, supra note 37, at 376-77.

111. See John C. Carter, The Rights of Other Corporate Constituencies, 22 MEM. ST. U. L. REV. 491 (1992) (stating that corporate directors have little direct liability to the constituencies other than shareholders); Roberta S. Karmel, Implications of the
does not require directors to give any consideration to any corporate constituent. By tying director duties to the best interests of the corporation, section 8.85 appears to vest only the corporation, or its shareholders suing derivatively, with standing to sue for a breach of the duty to act on the corporation's behalf.

From the perspective of non-shareholder corporate constituents, section 8.85 appears toothless. Indeed, there are many critics who view corporate constituency statutes as just another management entrenchment device foisted on shareholders by state legislatures held captive by powerful local companies.

Stakeholder Model, 61 GEO. WASH. L. REV. 1156, 1173 (1993) (stating that the corporate constituency statutes do not impose new duties on directors enforceable by creditors, employees, and other constituencies and warning that a "litigation explosion" would result if such duties were imposed). Strong arguments in favor of implying at least limited causes of action on behalf of non-shareholder constituents are found in Millon, supra note 18, at 257-60; Lawrence E. Mitchell, A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes, 70 TEX. L. REV. 579 (1992).

112. Of course, it is difficult to conceive of a situation where directors could identify the corporation's best interests without reference to any constituent.


114. See Millon, supra note 18, at 276 (noting that unless the constituency statutes are interpreted as imposing affirmative obligations on management, non-shareholders will receive little benefit from the statutes).

115. See, e.g., Kaplan, supra note 37, at 376-77 (stating that Section 8.85 reinforces management's defense posture against its own shareholders leaving shareholders defenseless against the hostile takeover maneuvers initiated by their own management); see also Johnson & Millon supra note 36; Romano, supra note 35.

By allowing directors to consider the interest of other constituents on par with the interests of shareholders and by making the "corporation" the primary focus of the fiduciary duties owed by directors, § 8.85 may make it more difficult for shareholders to prevail on breach of fiduciary duty claims. At a minimum, shareholder plaintiffs in breach of fiduciary duty cases should frame their case as much as possible as a claim charging directors with breaching their duty to the corporation. Framing suits as breach of duty claims is necessary because a shareholder plaintiff who claims a breach of duty claims is necessary because a shareholder plaintiff who claims a breach of fiduciary duty owed to the shareholder likely will be confronted with a defense that the challenged action was compelled by an overriding interest of the corporation and thus was sanctioned by § 8.85.

The problem with a shareholder focusing a breach of fiduciary duty case on harm to the corporation is that such an action likely will be treated as a derivative claim and will thus be subject to the various procedural hurdles associated with derivative actions. See ILL. COMP. STAT. ANN. ch. 805805 § 5/7.80. (West 1995). See also Mann v. Kemper Financial Companies, Inc., 618 N.E.2d 317 (Ill. App. Ct. 1992) (discussing aspects of individual versus derivative actions); Zokoych v. Spalding, 344 N.E.2d 805 (Ill. App. Ct. 1976) (stating that individuals could bring action in case where wrongful acts violate contractual duty). Consideration of the full implications of § 8.85 on shareholder derivative actions is beyond the scope of this article. See generally Thomas J. Bamonte, An Assessment of Derivative RICO Actions by Stockholders, Limited Partners
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A more charitable view, however, suggests that section 8.85 reflects a legislative determination that the many interests at work in a corporation must be balanced. Accordingly, the General Assembly has apparently determined that the best way to accommodate these interests is twofold: (i) require directors to balance these interests under the rubric of identifying and then acting in the best interests of the "corporation," and (ii) allow directors to consider "all pertinent factors," including the interests of non-shareholder constituents, in performing this task. The General Assembly may well have concluded that giving standing to non-shareholder constituents would generate costly and time-consuming litigation and encourage opportunistic behavior by powerful corporate constituents at the expense of less powerful or poorly organized constituents.\(^{116}\)

The literature abounds with discussions of possible common law causes of actions which corporate constituents might bring in response to a corporate action, such as a plant closing, that have a major adverse impact upon a constituency.\(^{117}\) However, the causes of action proposed by commentators, based on both contract and tort theories, has not found substantial judicial favor thus far.\(^{118}\)

If such causes of action ripen into viable claims, section 8.85 might have an important role to play in defining the duties owed by corporate directors. Assuming non-shareholders have standing, directors who callously disregard the interests of a corporate constituent might be viewed as reckless or worse in light of section 8.85, which gives directors the right to take into account those interests and, when viewed in historical context, seems to intend that they do so.\(^{119}\) At the present time, outside of clarifying to whom directors owe their primary

\(^{116}\) See Karmel, supra note 111, at 1173.


\(^{119}\) See, e.g., O'Connor, supra note 29, at 1232 ("With the widespread concern over the economic consequences of capital mobility, social conditions may be changing so that the courts may use stakeholder statutes as a basis for judicial intervention to ameliorate the impact of corporate restructuring.").
fiduciary duty, section 8.85 provides only a normative constraint on the actions of the directors with respect to corporate constituents.\textsuperscript{120}

An interesting question posits whether section 8.85 marks the first step towards a more radical restructuring of the corporation and of corporate law. In other words, might constituency statutes such as section 8.85 signal that "public" considerations, such as the impact of corporate decisions on non-shareholder constituencies, are gradually becoming issues to be dealt with under the rubric of the "private" law of corporations?\textsuperscript{121}

The prospects for at least a partial shift in that direction are not as slim as might be imagined. Other developed countries have utilized various devices designed to ensure that corporate decision-making more fully reflects the public dimension of corporate actions. Methods employed include the appointment of labor representatives on corporate boards, employee participation in the election of the board of directors, and the development of close working relationships among creditors, suppliers and the corporation.\textsuperscript{122}

Nevertheless, it is unlikely that states such as Illinois will be quick to restructure their corporate law to encompass a host of "public issues" in the near future. Protecting the prerogatives of those in control of the corporation continues as a principle deeply rooted in American corporate law.\textsuperscript{123} Given the influence of corporate management on the evolution of corporate law at the state level\textsuperscript{124} and the

\textsuperscript{120} The importance of normative constraints should not be underestimated. See Bernard S. Black, Is Corporate Law Trivial?: A Political and Economic Analysis, 84 Nw. U.L. Rev. 542, 573-74 (1990) (stating that cultural and extralegal norms of proper behavior play an important part in managerial self-restraint).


various market constraints on state corporate law innovations, states are unlikely to use corporate constituency statutes to reduce the powers and prerogatives of those in control of local corporations. The suggestion that state legislatures intended to use corporate constituency statutes to give a host of non-shareholder constituents new causes of action is nearly unthinkable.

Section 8.85 hints at a reservoir of transformative possibilities which someday may be tapped through political movements or judicial innovations as yet unseen. Section 8.85 does not, however, reduce the power wielded by incumbent management and, indeed, appears to consolidate the control of incumbent management over Illinois corporations.

V. CONCLUSION

Section 8.85 has attracted attention and elicited significant commentary as an antitakeover measure. Its primary significance to Illinois corporate law, however, has been overlooked. The primary and largely unrecognized significance of section 8.85 is that the statute settles an important question of Illinois corporate law by establishing that the foremost fiduciary duty of directors is to serve the best interests of a reified entity called the "corporation." Before Section 8.85, directors owed dual and sometimes contradictory duties to the corporation and its shareholders. Section 8.85 now establishes that the duty owed to the corporation is primary. Section 8.85 also displaces shareholders from the top of the legal hierarchy of corporate constituents. It vests directors with the right to consider and balance the interests of a full range of corporate constituents in the context of both regular business decisions and when corporate control is at stake. The importance of section 8.85, thus, extends far beyond the antitakeover realm, and its full implications have yet to be realized.


126. See Bratton, supra note 123, at 1468 (concluding that an expansive interpretation of corporate constituency laws is unlikely).

127. See supra notes 40-44 and accompanying text.

128. See supra note 45-48 and accompanying text.

129. See supra notes 100-110 and accompanying text.