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TRUST & TRANSPARENCY: PROMOTING EFFICIENT CORPORATE DISCLOSURE THROUGH FIDUCIARY-BASED DISCOURSE

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MICHAEL R. SIEBECKER*

ABSTRACT

Could embracing the philosophy of "encapsulated trust" as the basis for a fiduciary duty of disclosure improve the integrity and effectiveness of corporate communications? The question arises because a tragedy of transparency threatens the viability of the burgeoning corporate social responsibility (CSR) movement, where consumers and investors employ various social, environmental, or ethical screening criteria before purchasing a company's stock or products. In an efficient market, fully informed consumers and investors could reward companies that engage in CSR by purchasing their products or stock and, conversely, punish companies that fail to engage in desired practices by refusing to purchase their products or stock. Unfortunately, corporations are increasingly engaging in a sort of "strategic ambiguity" in their public communications—an ambiguity made possible by a variety of static yet inconsistent standards regarding the collection, auditing, and dissemination of information regarding CSR practices. Consumers and investors simply cannot trust the existing disclosure regime to provide reliable information necessary to monitor CSR compliance. That lack of trust will cause the market for CSR to collapse, as consumers and investors stop offering rewards for responsible business behavior.

The Article suggests solving that disclosure tragedy by using the philosophy of "encapsulated trust" to reshape the existing fiduciary duties governing officers and directors. In simple terms, encapsulated trust constitutes a rational expectation that others will take our interests into

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account when determining what course of action to pursue. Applied in the context of corporate disclosures on CSR, encapsulated trust would require officers and directors to demonstrate they took into account shareholder preferences regarding the timing, content, and form of corporate disclosures. In essence, the duty is a process-based standard that relies on continual discourse to improve the integrity of disclosure practices. In contrast to static statutory disclosure rules, an emphasis on improved discourse between the corporations and shareholders would promote greater efficiency in corporate communication by attending more accurately to evolving consumer and investor disclosure preferences. Moreover, the focus on greater discourse within the corporate setting would also lead to enhanced ethical practices by corporate actors and their counsel.

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I. INTRODUCTION

Could embracing the philosophy of "encapsulated trust" as the basis for a fiduciary duty of disclosure improve the integrity and effectiveness of corporate communications?

The question arises because, despite a host of federal and state statutes mandating disclosure of various corporate practices, corporations seem reluctant to disclose fully what consumers and investors want to know, when they want the information, and in a manner they find accessible. For example, in January 2009, *USA Today* reported that Monster.com "*quietly posted an online notice* Friday disclosing that its customer databases had been hacked for the second time in six months."[1] The disclosure did not occur until five days after Monster.com became aware of the breach.[2] Around the same time, Heartland Payment Systems learned of a massive security breach that potentially put at risk the financial information of 100 million credit card users.[3] A week after confirming the breach and several months after beginning the investigation, Heartland ultimately disclosed the breach publically—on Inauguration Day, when other news obviously occupied the headlines.[4] Those are just two of many examples where corporations arguably failed to disclose—or to disclose effectively—important information relevant to consumers and investors.

Ineffective corporate disclosures become especially problematic in the context of the CSR movement, where consumers and investors employ various social, environmental, or ethical screening criteria before purchasing a company's stock or products. As the bases upon which consumers and investors make purchasing decisions grow, calls for greater

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1. Byron Acohido, *Hackers Hit Monster.com's Customer Data Again*, USA TODAY, Jan. 28, 2009 (emphasis added).

2. For a criticism of the timing, content, and manner of the disclosure, see Mike Dailey, *An Open Letter to Monster.com Management* (Jan. 27, 2009), *available at* http://daileymuse.com/2009/01/an-open-letter-to-monstercom-management.

3. Byron Acohido, *Hackers Breach Credit System Heartland Processes Millions of Purchases*, USA TODAY, Jan. 21, 2009.

4. Jaikumar Vijayan, *Heartland Data Breach Sparks Security Concerns In Payment Industry: Lack Of Details, Company's Size Spur Questions About How System Intrusion Happened*, COMPUTERWORLD, Jan. 22, 2009, *available at* http://www.computerworld.com/action/article.do?command=viewArticleBasic&articleId=9126608; *see also* Jaikumar Vijayan, *Heartland's Breach Disclosure Timing Raises Eyebrows*, COMPUTERWORLD, Jan. 21, 2009, *available at* http://blogs.computerworld.com/heartland_breach:

> The timing of Heartland Payment Systems' announcement that its networks had been broken into last year by unknown intruders has raised a few eyebrows. Some see yesterday's announcement as an attempt by the Princeton, N.J.-based payment card processor to bury the bad news on a day when the media and the public at large were totally consumed with President Barack Obama's inauguration.

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corporate transparency increase as well. Excessive amounts of disclosure, or communication of poor quality information, can actually impede rather than promote corporate accountability. Unintentional obfuscation may turn into bald deception, as corporations seek market advantages by promoting a false socially responsible image. Absent effective dissemination of reliable information regarding socially responsible business practices, a tragedy of transparency may result that threatens the basic viability of the CSR movement.

The basic problem of corporate disclosures on CSR represents a version of the classic Prisoner's Dilemma. In an efficient market, fully informed consumers and investors could reward companies that engage in CSR by purchasing their products or stock, and, conversely, punish companies that fail to engage in desired practices by refusing to purchase their products or stock. Unfortunately, corporations increasingly engage in a sort of "strategic ambiguity" in their public communications—an ambiguity made possible by a variety of static, yet inconsistent, standards regarding the collection, auditing, and dissemination of information concerning CSR practices. In a slight modification of the classic dilemma, the cooperative postures are for corporations to embrace and report accurately CSR practices and for consumers and investors to purchase the services or stock of compliant companies. In contrast, the defective postures are for corporations not to embrace and to report inaccurately compliance with CSR preferences and for consumers and investors not to purchase the services or stock of those non-compliant companies. Assuming consumers and investors are willing to offer greater rewards to compliant companies than the cost to those businesses of adopting desired CSR practices, the cooperative position represents true economic gain. Moreover, because corporations, consumers, and investors represent repeat players who could punish defection in continual iterations of the game over time, the equilibrium position should be mutual cooperation or embracing CSR practices.

But absent trustworthy auditing processes, enforcement mechanisms, or robust disclosure requirements that ensure full transparency, it becomes difficult for consumers and investors to detect when a company in fact adopts a defective posture. What results is true economic waste—a destruction of the market for good CSR practices, because consumers and investors will not be willing to pay a premium for CSR practices, unless they can rely on the accuracy of a corporation's statements.

As a general matter, looking to the philosophy of trust for guidance on how to correct this disclosure dilemma should not seem terribly odd. After all, the fiduciary duties that officers and directors owe to the corporation

represent essential trust relationships. Although the fiduciary duties of care and loyalty provide the backbone of modern corporate law, they remain frustratingly amorphous as currently applied by courts. Many assert that reliance on abstract concepts of fiduciary duties results in a system of inconsistent and indeterminate regulation of corporate behavior. According to critics, that fiduciary duties of care and loyalty exist says precious little about the particular contexts in which those duties necessarily arise or the content of the duties in any circumstance.

Reshaping those currently indeterminate fiduciary duties around the concept of encapsulated trust, however, could promote a kind of "best practices" regarding corporate communications on CSR issues. But what is encapsulated trust? In simple terms, encapsulated trust constitutes a rational expectation that others will take our interests into account when determining what course of action to pursue. Considered in that light, maintaining encapsulated trust requires an ongoing discourse within the trust relationship to determine competently the interests at stake and to assess the best means though which others encapsulate those interests in pursuing a particular course of action. Applied in the context of corporate disclosures on CSR, encapsulated trust would require that directors and officers take into account the interests of shareholders of the corporation in determining the substance and form of corporate communication. Satisfying a duty based on encapsulated trust would require engaging those corporate constituencies in an ongoing dialogue about the preferred level of corporate communication and the form for reporting information.

So with that basic understanding, how would courts apply encapsulated trust in the context of a fiduciary duty of disclosure? Arguably, if challenged, directors and officers would need to demonstrate that in making a particular disclosure, they competently took into account the interests of shareholders regarding the substance and form of the disclosure. If a disgruntled shareholder argued that the officers and directors violated their duty of care by failing to disclose effectively important information about CSR practices, company actors would need to demonstrate only that the disclosure took into account the interests of shareholders following an ongoing dialogue about the content, form, and timing of disclosures on such matters. In essence, the duty is a *process-based standard* that relies on enhanced discourse to improve the integrity of decisions on corporate disclosures. Although perhaps rather modest in scope, that emphasis on improved discourse between the corporations and their constituencies should provide substantial improvements over the current disclosure regime.

Perhaps most important, encapsulated trust promotes "best practices" in corporate disclosures by encouraging an efficient level of corporate communication. Efficient corporate communication represents the level of disclosure that corporate managers, shareholders, consumers, and other stakeholders would hypothetically negotiate in a world of perfect information and without the burdens of transaction costs in bargaining. The precise outcome of that hypothetical negotiation would necessarily change as the preferences of any party evolve.

Without doubt, fiduciary duties based on encapsulated trust would impose a more stringent duty of care on officers and directors, at least with respect to the *process* of attending to those duties. Some might charge that the inherent flexibility in the common law duties would produce a lack of clarity and predictability, resulting in significantly increased litigation costs. Those costs, however, do not necessarily impede moving toward an efficient level of corporate communication. Instead, those costs actually facilitate a Pareto improvement over a statutory disclosure regime by encouraging corporations to pay continual attention to the evolving preferences for disclosure of CSR practices.

Although adhering to existing static statutory disclosure standards would promote predictability, the very immovability of those standards could not accommodate changing market preferences regarding the desired content of corporate communication. Thus, determining whether a malleable fiduciary duty approach or a much more static statutory framework would enhance the likelihood of an efficient level of disclosure depends on an assessment of the nature of market preferences. If those preferences remain static, enduring the costs of a malleable approach would seem wholly unnecessary. On the other hand, if market preferences regarding the substance and character of corporate communication evolve, only a malleable common law approach could attend adequately to those changing preferences.

Considering the celerity with which observed CSR practices and preferences change, a malleable fiduciary duty of disclosure seems to facilitate a Pareto improvement over continued adherence to static disclosure duties. Corporations will continually be obligated to reflect on the quantitative and qualitative sufficiency of their public disclosures. Rather than providing a one-size-fits-all disclosure standard for every corporation, a fiduciary disclosure duty based on encapsulated trust requires a rather disciplined organizational introspection. What marks sufficient disclosure for any corporation will depend on the dialogue between the corporation and its constituencies regarding the substance of corporate disclosures, as well as the manner of those disclosures.

The point is not that corporations must heed every shareholder preference regarding information disclosure. Rather, by instantiating encapsulated trust in a disclosure duty, corporations will continually refine as a matter of course their own understanding of what marks appropriate disclosure practices. To be sure, the threat of litigation from disgruntled shareholders provides the incentive to engage in the reflective process. But as that practice takes hold and shareholders become a regular part of the dialogue regarding corporate disclosure practices, the instances of litigation should wane. For by engaging and taking seriously the discourse, the corporations fulfill their duty based on encapsulated trust and thereby insulate themselves from liability.

By promoting a process of discourse between the corporation and its shareholders, then, an encapsulated interest account of trust promotes best practices in corporate disclosures regarding CSR. While steadfast reliance on static disclosure standards would undermine efficiency despite providing predictability, a common law duty of disclosure based on encapsulated trust would provide flexible standards for corporate communication that evolve as market preferences change. In the end, not only could encapsulated trust provide a means to escape the current Prisoner's Dilemma that threatens the viability of the market for CSR, but the focus on greater discourse within the corporate setting could lead to enhanced ethical practices by corporate actors and their counsel.

To examine the usefulness of encapsulated trust for regulating corporate disclosure obligations, Part II describes the tragedy of transparency that plagues current corporate communication. In particular, after detailing the allure of CSR to consumers, investors, and corporations, the Article surveys the systemic information failures that threaten the basic viability of CSR. Moving from tragedy to a potential solution, Part III attempts to rehabilitate trust as a useful organizing concept in corporate law. After assessing how well an encapsulated interest account of trust might fit within the existing fiduciary duty framework governing corporate actors, Part III details the various characteristics of encapsulated trust relevant to crafting a more analytically rigorous fiduciary duty of disclosure. Part IV then examines the repercussions of embracing encapsulated trust as a foundation of corporate disclosure duties and pays particular attention to effects on corporate efficiency, stakeholder engagement, and business ethics. The Article concludes in Part V that an encapsulated interest account of trust could preserve the viability of CSR by diminishing the gap between manager and shareholder incentives. Moreover, embracing encapsulated trust would cause corporations to

engage in a richer dialogue with various corporate constituencies and promote a more ethical business and legal environment.

II. THE TRAGEDY OF TRANSPARENCY

A growing tragedy of transparency threatens the viability of CSR.[5] The tragedy results from a confluence of factors that create incentives for corporations to dissemble, or to embrace a kind of strategic ambiguity[6] in their public communications. What makes the situation tragic is not just some moral disapprobation regarding the lack of integrity in corporate communication. While solid normative grounds certainly exist upon which to defend transparency as an end in itself,[7] the prospect of significant economic waste compounds any normative concerns. In fact, the tragedy becomes most apparent when examined through the lens of efficiency. To the extent consumer preferences for CSR and socially responsible investing provide compliant companies opportunities for economic gain (e.g., by enjoying higher consumer prices, stock premiums, or cheaper access to capital), an opportunity for wealth creation exists that satisfies the preferences of consumers, investors, and corporate shareholders alike. That classic win-win opportunity quickly devolves into economic waste if investors and consumers stop rewarding companies for engaging in socially responsible behavior because the market simply cannot trust the authenticity of purportedly responsible corporate practices or the veracity of corporate communications. Absent some correction to the existing legal and regulatory framework, the tragedy of transparency may ultimately cause the demise of CSR.[8] Understanding more fully how the tragedy transpires represents the initial step in the investigation.

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5. *See infra* Part II.C.1.

6. The term "strategic ambiguity" refers to the practice of corporations to communicate "in ways that may not be completely open" in order protect corporate interests. Eric M. Einsenberg & Marsha G. Witten, *Reconsidering Openness in Organizational Communication*, 12 ACAD. OF MGMT. REV. 418, 418 (1987); *see also* Eric M. Eisenberg, *Ambiguity as Strategy in Organizational Communication*, 51 COMM. MONOGRAPHS 227 (1984).

7. *See* James J. Brummer, *Accountability and the Restraint of Freedom: A Deontological Case for the Stricter Standard of Corporate Disclosure*, 5 J. BUS. ETHICS 155 (1986) (discussing the Kantian notion that corporate transparency remains an end in itself).

8. This current situation differs from other areas of complex regulation where a lack of transparency prevents meaningful regulation at the outset. *See, e.g.*, D. Daniel Sokol, *What Do We Really Know About Export Cartels and What is the Appropriate Solution?*, 4 J. COMPETITION L. & ECON. 967 (2008) (addressing lack of transparency in the antitrust context).

A. The Allure of Corporate Social Responsibility

Social responsibility occupies an increasing and prominent concern in corporate life. But why do companies embrace CSR at the outset? Quite simply, CSR remains inextricably tethered to consumer and investor preferences.[9] To the extent investors and consumers reveal a preference for purchasing stock or products of companies that adopt certain practices, companies may face an incentive to embrace those preferences.[10] That a strong connection exists between consumer choice and corporate behavior should come as no surprise. Efforts to encourage CSR have roots many centuries old.[11] The modern socially responsible investing (SRI) movement, however, arose in the aftermath of the social and political foment of the 1960s.[12] Since that time, and with increasing frequency, consumers and investors have screened corporate activities for positive compliance with desired practices, such as engaging in fair-trade policies with suppliers, or for avoidance of disfavored activities, such as deforestation.[13] According to one recent consumer survey, more than two-thirds of American consumers report "knowing that a company is following global standards for being socially responsible would be 'extremely' or 'very' influential in their decisions to purchase a particular product or service" from that company.[14]

What began as a movement based on individual consumer preferences now counts among its ranks large institutional investors and money managers. As more money gets invested based on various social screening criteria, the influence of SRI inevitably grows.[15] In June 2008, the United

9. *See* Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613, 623–24 (2006).

10. For a full discussion of the rise of SRI and shareholder advocacy, along with a description of corporate responses to those activities, see *id.* at 623–26.

11. SOC. INV. FORUM, 2005 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 3 (2006), *available at* http://www.socialinvest.org/pdf/research/Trends/2005%20 Trends%20Report.pdf [hereinafter 2005 SIF REPORT].

12. *Id.* at 3–4.

13. *See id.* at 2–3; *see also Brand New Day*, ECONOMIST, June 19, 1993, at 70–71 (describing the upcoming "era of corporate image, in which consumers will increasingly make purchases on the basis of a firm's whole role in society: how it treats employees, shareholders and local neighbourhoods."); Tom J. Brown & Peter A. Dacin, *The Company and the Product: Corporate Associations and Consumer Product Responses*, 61 J. MKTG. 68 (1997); Sankar Sen & C.B. Bhattacharya, *Does Doing Good Always Lead to Doing Better? Consumer Reactions to Corporate Social Responsibility*, 38 J. MARKET RES. 225 (2001).

14. FLEISHMAN HILLARD & NAT'L CONSUMERS LEAGUE, RETHINKING CORPORATE SOCIAL RESPONSIBILITY, FLEISHMAN-HILLARD/NATIONAL CONSUMERS LEAGUE STUDY 38 (2007).

15. Press Release, Social Investment Forum, Trends Report (Jan. 24, 2006), http://www.social invest.org/news/releases/pressrelease.cfm?id=61 (quoting Tim Smith) ("Over the past decade, SRI has

Nations reported that owners and managers of worldwide assets valued at more than $14 trillion had signed the U.N. Principles for Responsible Investment, an international compact whereby signatories pledge to screen investments based on certain environmental, social, and governance issues.[16] Within the United States, approximately "one out of every nine dollars under professional management in the United States today is involved in socially responsible investing" for a total aggregate value in excess of $2.7 trillion.[17] That $2.7 trillion value reflects an increase of 324% from 1995 and represents over 18% greater growth than assets under professional management not screened based on social criteria from 2005 to 2007.[18] Moreover, between 2005 and 2007, there has been a 28% increase in institutional investor assets screened on social and environmental criteria and a 32% increase in funds dedicated to community investing projects.[19]

Complementing the rapidly growing aggregate value of assets screened on CSR criteria, shareholder advocates seem to enjoy increasing success in pursuing socially responsible initiatives. In recent years, the number of shareholder proposals on proxy ballots related to CSR concerns has grown markedly.[20] Moreover, between 2005 and 2007, overall voting support on shareholder sponsored environmental and social initiatives increased by 57%.[21] With respect to large institutional investors that filed resolutions on social or environmental issues, assets under their control reached $703 billion.[22] Although some question the efficacy of direct shareholder involvement in managing company affairs,[23] others assert that shareholder

become a major force in the U.S. financial marketplace.") [hereinafter 2006 Trends Report].

16. Press Release, United Nations Principles for Responsible Investment, Principles for Responsible Investment: Signatories Double in One Year; Institutional Investors "Taking Implementation to the Next Level." (June 17, 2008), http://www.unglobalcompact.org/NewsAndEvents/news_archives/2008_06_17a.html.

17. SOC. INV. FORUM, 2007 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES ii (2007), *available at* http://www.socialinvest.org/pdf/SRI_Trends_ExecSummary_2007.pdf [hereinafter 2007 SIF REPORT].

18. *Id.*

19. *Id.* at iii–iv.

20. Lisa M. Fairfax, *Making the Corporation Safe For Shareholder Democracy*, 69 OHIO ST. L.J. 53, 89 (2008).

21. 2006 Trends Report, *supra* note 15.

22. *Id.*

23. *See* Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 741 n.27 (2007) ("most studies found *no* correlation between increased shareholder activism and long-term share value, many have found that 'the long-run average stock return [of companies targeted by activists] is negative and in some cases statistically significant'") (citations omitted). *But see* Fairfax, *supra* note 20, at 89 ("This evidence reveals that shareholders' increased activism and power

advocates continue to play "a major role in improving corporate behavior through resolutions, letter writing, and negotiations with management on issues ranging from environmental risk and workplace standards to diversity, human rights violations, and a myriad of corporate governance concerns."[24] At the very least, shareholder advocacy through the proxy process provides a need for corporations to address publicly a variety of social, ethical, political, and environmental matters relevant to the SRI community.

Despite the increasing demand by consumers and investors for corporations to embrace CSR, a corporate decision to embrace socially responsible business practices may very well depend on the benefits corporations enjoy (or costs they avoid) through compliance. The willingness of investors and consumers to pay some premium in stock or product price for CSR practices represents one such potentially important benefit.[25] Of course, that same incentive exists if consumers and investors effectively punish non-compliant corporations by selling stock or by refusing to purchase stock or products at the outset. The basic point remains that without some identifiable incentive for corporations to embrace CSR, the costs of compliance might simply outweigh potential benefits and cause corporations to ignore calls for changing business practices.[26]

The existence of any stock premium, increased product price, or other potential benefits conferred by embracing CSR remains a source of continuing debate. Some argue that typically flat demand curves for corporate stock make it highly unlikely SRI screening activities will have more than a negligible effect on corporate policies.[27] Contrary evidence suggests that real monetary incentives exist for corporations to embrace

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have not had a negative impact on stakeholder issues. Instead, such concerns appear to have benefited from increased shareholder activism.").

24. 2005 SIF REPORT, *supra* note 11, at 21.

25. *See* Siebecker, *supra* note 9, at 624.

26. Many academics and market professionals suggest that companies should embrace CSR practices because they promote long-term shareholder value, regardless of any premium for stock or product price a compliant company might garner. *See, e.g.*, GEORGE POHLE & JEFF HITTNER, IBM GLOBAL BUS. SERVS., ATTAINING SUSTAINABLE GROWTH THROUGH CORPORATE SOCIAL RESPONSIBILITY 1 (2008), *available at* http://www-935.ibm.com/services/us/index.wss/ibvstudy/gbs/a1029293 [hereinafter POHLE & HITTNER]; Joe W. (Chip) Pitts III, *Business, Human Rights, & the Environment: The Role of the Lawyer in CSR & Ethical Globalization*, 26 BERKELEY J. INT'L L. 479, 485 (2008).

27. *See* Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681 (2002) ("[T]he cost of screening in a well-diversified portfolio is probably very small and that screening is likely to have, at most, a tiny direct effect on targeted firms' actions.").

CSR. Some studies indicate socially screened mutual funds outperform non-screened funds[28] and that companies embracing CSR enjoy greater long-term growth with less share volatility.[29] As anecdotal evidence, some CSR advocates cite the consistently strong performance of the Domini 400 Social Index, a bellwether CSR fund.[30] Over an 18-year period, the Domini 400 Social Index outperformed the S&P 500 Index, which measures the performance of 500 major companies in the United States across diverse industry groups.[31] With respect to the willingness of consumers to pay a premium for CSR products, at least one rather informal comparison of commodity prices with their free-trade counterparts concludes that consumers demonstrate a willingness to pay as much as 10% more for socially responsible products.[32]

Although the integrity of assessing the incentives for embracing CSR would benefit from more robust empirical studies, the actual behavior of corporations may provide some of the most probative insights into the existence of potential gains through embracing socially responsible business practices. A 2008 survey of international business leaders surveyed by IBM indicates that 68% of those surveyed focus on CSR activities to generate new revenue and that 54% believe current CSR initiatives give their company an advantage over competitors.[33] To the extent corporations accurately report those benefits, real incentives exist for them to embrace socially responsible business practices.

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28. *See* Meir Statman, *Socially Responsible Mutual Funds*, 56 FIN. ANALYSTS J. 30 (Oct. 2000).

29. *See* Aaron A. Dhir, *Recent Development of Takeovers, Foreign Investment and Human Rights: Unpacking the Noranda-Minmetals Conundrum*, 22 BANKING & FIN. L. REV. 77, 94 (2006):

> Studies have certainly identified a positive relationship between socially responsible corporate behaviour and financial success, in particular with respect to share value. For example, businesses with ethically sound environmental policies enjoy less share value volatility than those without and organizations "with a serious commitment to ethical behavior outperform those without such a commitment over the long term."

Id. (citations omitted); *see also* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1284–86 (1999).

30. KLD Research Analytics, Inc., Domini 400 Social Index Performance, http://www.kld.com/indexes/ds400index/performance.html (last visited Sept. 7, 2008).

31. For a description of the S&P 500 Index, see Standard and Poor's S&P 500 Fact Sheet, http://www2.standardandpoors.com/spf/pdf/index/SP_500_Factsheet.pdf (last visited July 19, 2009).

32. Posting of Jerry Lao to Sproutly, http://www.sproutly.com/2008/05/08/value-of-social-responsibility-in-the-us-530-billion (May 8, 2008).

33. POHLE & HITTNER, *supra* note 26, at 3.

B. The Campaign of Corporate Images

As SRI continues to flourish, corporations respond in kind to public concerns about socially responsible business practices. In 2008, 86% of companies in the S&P 100 Index included information about social and environmental business practices on their websites.[34] Moreover, 49% of those same companies issued special "sustainability reports" upon which investors and consumers in the SRI community rely.[35] Because companies may face market backlash when negative reports surface regarding unsavory social, labor, or environmental practices,[36] many corporations now work together with SRI funds and shareholder advocacy groups to build into their business plans specific policies responsive to the SRI community.[37]

Regardless of whether or not corporations actually embrace a cooperative posture in striving to achieve the goals of the SRI community, it seems all too clear that corporations increasingly heed the market's demand for disclosures regarding business practices and operations relevant to SRI.[38] As a recent PriceWaterhouseCoopers study indicated, many large U.S. companies consider their stance on labor, environmental, and social practices to be "the next competitive battlefield."[39] Engaging on

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34. Press Release, Social Investment Forum, Sustainability Reporting by S&P 100 Companies Made Major Advances From 2005–2007 (July 17, 2008), http://www.socialinvest.org/news/releases/pressrelease.cfm?id=112.

35. *Id.*; *see also* Michelle Berhart & Alyson Slater, *How Sustainable is Your Business?*, COMM. WORLD, Nov.–Dec. 2007, at 1.

36. For example, Domini Investments, a bellwether SRI fund, dropped Wal-Mart from its socially responsible index fund, the Domini 400, based on reports about poor labor and human rights conditions involving its overseas suppliers. *See* Ellen Braunstein, *Hot Topic: From Sweatshops To Shopping Malls*, RETAIL TRAFFIC, Sept. 1, 2001, *available at* http://retailtrafficmag.com/mag/retail_hot_topic_sweatshops/ (describing Domini's decision based on a "report from the National Labor Committee that Wal-Mart goods were made by nearly enslaved workers under armed guard in Honduras and China. Wal-Mart's 'Kathie Lee' goods were made by 13-year-olds in Honduras, forced to work 13 hours a day, the report states.").

37. *See* Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 528–29 (2005); Matthew Hirschland, *Whose Responsibility? CSR, Business and Public Policy: Why Going It Alone Is Not an Option*, LEADING PERSPECTIVES, Winter 2006, at 1, *available at* http://www.bsr.org/reports/leading-perspectives/2006/2006_Winter.pdf; *see also* Stacey Smith, *Navigating the Stakeholder Relations Continuum*, LEADING PERSPECTIVES, Fall 2004, at 6, *available at* http://www.bsr.org/reports/leading-perspectives/2004/Fall.pdf; POHLE & HITTNER, *supra* note 26, at 3.

38. For a detailed discussion of the link between social investment and corporate accountability, see Williams, *supra* note 29, at 1293–1306.

39. Clinton Wilder, *The Next Competitive Battlefield—The Sustainability Movement's 'Triple Bottom Line' Requires IT Execs To Deliver Better Data*, OPTIMIZE, Aug. 1, 2002, at 76 (internal quotation marks omitted).

the battlefield requires corporations to speak on a variety of social, political, ethical, and environmental matters.

The drive to speak about CSR practices in order to capture a competitive advantage in the marketplace has sparked some massive media campaigns. Multinational corporations like British Petroleum, General Electric, and Wal-Mart, to name only a few, have invested huge sums to communicate an image of CSR to consumers and investors.[40] The allure of CSR, then, results in greater public calls for corporate disclosures and corporations' concomitant drive to project images of social responsibility that secure the greatest market advantage.

C. Corporate Communication Failures

Systemic failures regarding the compilation, auditing, communication, and processing of information lead to a tragedy of transparency that threatens the basic viability of CSR. Because "the effectiveness of the CSR model pivots on information,"[41] without a reliable means to assess accurately corporate communications regarding their business practices, consumers and investors may be stripped of a means to encourage socially responsible business practices. Perhaps somewhat oddly, it is not simply the lack of information that causes the tragedy. Instead, it can also be high volume and low quality of information that puts CSR at risk. Thus, fueling the tragedy of transparency is a group of connected information failures that render assessing the truth or falsity of corporate communications increasingly difficult.

1. Definitional Ambiguity

A persistent definitional ambiguity regarding what constitutes CSR lies at the heart of the systemic information failures in corporate communication. Defining what CSR entails presents a rather difficult task. A recent IBM study describes CSR as a management practice that produces an overall positive impact on society through social, ethical, and environmental initiatives.[42] Adopting a definition more sensitive to corporate profit making than IBM's stance, the World Bank described

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40. Moira Herbst, *Energy Efficiency: A Passing Fad?*, BUS. WK. ONLINE, Mar. 11, 2008, at 2, http://www.businessweek.com/bwdaily/dnflash/content/mar2008/db20080310_387188.htm.

41. LYUBA ZARSKY, HUMAN RIGHTS AND THE ENVIRONMENT 48 (2002).

42. *See* POHLE & HITTNER, *supra* note 26, at 1 ("Corporate Social Responsibility is the way companies manage their businesses to produce an overall positive impact on society through economic, environmental and social actions.").

CSR as a "commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large to improve their lives in ways that are good for business and for development."[43] Some conceptions of CSR target every aspect of the production process,[44] while others focus more narrowly on specific human rights or environmental concerns.[45] With the abounding definitions of CSR in academic and professional literature, pinning down exactly what constitutes CSR is, as one scholar suggests, "like trying to nail Jell-O to the wall."[46]

Companies that embrace CSR typically eschew the constraint of short-term shareholder wealth maximization as the singularly appropriate mandate for making business decisions.[47] But even with that common link, it remains wholly unclear whether CSR entails any or all of supporting specific charitable causes, paying living wages to overseas workers, embracing environmentally sound business practices, avoiding animal testing of products, adopting robust ethical codes for business conduct, or a host of other concerns.[48] Interpreting broadly the relevant constituencies whose interests require consideration, managers of socially responsible companies often take into account not just the interest of shareholders concerned with maximizing short-term gain, but also the interests of long-term holders or other corporate stakeholders, such as employees, consumers, suppliers, community groups, and other participants of civil

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43. *See* HALINA WARD, CORPORATE SOCIAL RESPONSIBILITY PRACTICE OF THE WORLD BANK GROUP, PUBLIC SECTOR ROLES IN STRENGTHENING CORPORATE SOCIAL RESPONSIBILITY: TAKING STOCK 3 (2004).

44. *See* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 38 (Andrew Crane et al. eds., 2008) ("'CSR is viewed as a comprehensive set of policies, practices and programs that are integrated into business operations, supply chains, and decision-making processes throughout the company.'").

45. *See, e.g.*, Ilias Bantekas, *Corporate Social Responsibility in International Law*, 22 B.U. INT'L L.J. 309 (2004) (suggesting that CSR properly focuses on human rights and environmental justice).

46. Peter Madsen, *Professionals, Business Practitioners, and Prudential Justice*, 39 MCGEORGE L. REV. 835, 836 (2008); *see also* David Monsma, *Equal Rights, Governance, and the Environment: Integrating Environmental Justice Principles in Corporate Social Responsibility*, 33 ECOLOGY L.Q. 443, 480 n.204 (2006); Antonio Vives, *Corporate Social Responsibility: The Role of Law and Markets and the Case of Developing Countries*, 83 CHI.-KENT L. REV. 199, 200–01 (2008) (arguing that the variety of extant definitions for CSR produces heated controversies about the appropriate goals of corporate actors); Cynthia A. Williams, *A Tale of Two Trajectories*, 75 FORDHAM L. REV. 1629, 1647 n.54 (2006) ("Legal academics have struggled to produce useful definitions of CSR, and in that effort may be well advised to look to the management literature.").

47. Judd F. Sneirson, *Doing Well by Doing Good: Leveraging Due Care for Better, More Socially Responsible Corporate Decisionmaking*, 3 CORP. GOVERNANCE L. REV. 438, 443–44 (2007).

48. *See, e.g.*, Colin P. Marks, *Jiminy Cricket for the Corporation: Understanding the Corporate "Conscience"*, 42 VAL. U. L. REV. 1129, 1148–51 (2008) (discussing the various notions of what good corporate behavior entails in the corporate consciousness).

society.[49] Which particular interests corporate managers heed depend, of course, on the precise notion of CSR embraced.[50]

Although the lack of definitional precision betokens the breadth of activities that fall under the CSR umbrella, the ambiguity also creates significant disclosure challenges.[51] Managers simply might not know what information demonstrates compliance with any particular concept of CSR.[52] Although it might be easy to report the earnings of overseas employees and suppliers, those raw numbers might not fully depict whether the wages constitute "living wages" or whether a product resulted from "fair-trade" practices. Moreover, providing disclosure sufficient to satisfy one notion of CSR embraced by certain consumers and investors does not imply the disclosure is sufficient to satisfy other potentially competing notions of what social responsibility entails.[53]

2. *Incoherent Standards*

A lack of coherent standards for collecting, reporting, and auditing CSR data compounds the definitional problem.[54] In some sense, the definitional ambiguity regarding the basic content of CSR renders the incoherence inevitable. Without a common sense of what needs to be measured, the metrics employed for data collection and reporting seem bound to vary.

Efforts to enhance the uniformity of reporting social data certainly exist.[55] But uniformity alone does not necessarily produce meaningful

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49. *See* Siebecker, *supra* note 9, at 623–24; POHLE & HITTNER, *supra* note 26, at 4.

50. *See* Ronen Shamir, *Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility*, 38 LAW & SOC'Y REV. 635, 646–48 (2004) (discussing how firms embrace social responsibility depending on the particular notion of good corporate citizenship at stake).

51. *See* Monsma, *supra* note 46, at 475–81; *see also infra* notes 54–58 and accompanying text.

52. POHLE & HITTNER, *supra* note 26, at 9.

53. *See* Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 639–42 (1982).

54. *See* Martin Lutz, *The Lawyer's Role in Mitigating CSR Risk*, 99 AM. SOC'Y INT'L L. PROC. 267, 268 (2005):

> This lack of clarity as to CSR standards has important consequences to those of us advising clients on how to avoid litigation risk. Indeed, unclear legal standards, or the faulty application of standards, can cause the wrong sorts of incentives. In the CSR context, if the relevant legal standards are unclear, or are applied in an inconsistent and unpredictable way, then the risks attendant to any particular foreign investment will become more difficult and expensive to manage..

Id.

55. *See* Cynthia A. Williams, *Civil Society Initiatives and "Soft Law" in the Oil and Gas Industry*, 36 N.Y.U. J. INT'L L. & POL. 457, 471–92 (2004) (describing three different reporting

disclosure. Uniformity could come at the expense of informational integrity, if pandering to the least common denominator is required to gain universal acceptance of collection and reporting standards.[56] So even if uniformity makes commensurable comparisons among corporations possible on some level, unless the disclosed data provides sufficient understanding, the comparisons are fruitless at the start.[57]

Moreover, since the notion of what constitutes CSR varies and evolves as values change, a static and uniform approach to defining corporate disclosure obligations might not yield relevant information.[58] If the definition of CSR remains essentially malleable, changing over time in different corporate contexts, the disclosure obligations might need to accommodate that flexibility. Currently, the CSR movement suffers from a lack of uniformity as well as a lack of meaningfully fluid standards that could produce sufficient transparency.

3. Data Dumping

Some corporations attempt to satisfy disclosure obligations through massive "data dumping."[59] Burying material facts in excessive amounts of information regarding corporate practices, however, impedes the ability of individuals, and even sophisticated institutional investors, from making sound judgments.[60] In one obvious sense, information overload increases

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initiatives, including the Global Reporting Initiative, that attempt to increase uniformity in CSR disclosures).

56. *See* Richard A. Rinkema, *Environmental Agreements, Non-State Actors, and the Kyoto Protocol: A "Third Way" For International Climate Action?*, 24 U. PA. J. INT'L ECON. L. 729, 753 (2003).

57. For a discussion of the market's need for accurate reporting regarding CSR practices and the incommensurability of current reporting methods, see David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137, 159–61 (2007).

58. *Id*. at 195–96 (suggesting that corporate managers continually review disclosure practices rather than relying on static disclosure standards to guide corporate communication).

59. *See generally* Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003).

60. *See, e.g.*, Seinfeld v. Becherer, 461 F.3d 365, 370–71 (3d Cir. 2006) (agreeing with a district court analysis that gathering too much information about stock options in a proxy statement "would result in an avalanche of trivia that would serve only to confuse shareholders"); Werner v. Werner, 267 F.3d 288, 297 (3d Cir. 2001) (describing the "buried facts" doctrine as deeming a disclosure inadequate when the disclosure "is presented in a way that conceals or obscures the information sought to be disclosed" and noting that the doctrine "applies when the fact in question is hidden in a *voluminous document* or is disclosed in a piecemeal fashion [that] prevents a reasonable shareholder from realizing the 'correlation and overall import of the various facts interspersed throughout' the document" (emphasis added) (quoting Kas v. Fin. Gen. Bankshares, Inc., 796 F.2d 508, 516 (D.C. Cir. 1986)); *Kas*, 796 F.2d at 516 (endorsing the notion that "'full and fair disclosure cannot be achieved through piecemeal release of subsidiary facts [that] if stated together might provide a sufficient

the cost of sifting through data to locate the relevant facts.[61] Moreover, rather than expending the costly effort to wade through large amounts of data, individuals often adopt heuristic short-cuts that impair effective analysis.[62] It is no secret to corporations that producing enormous amounts of information in response to consumer and investor demands can undermine adequate understanding. As one multi-national corporation recently reported, "you can't call it transparency if you simply spew information out into the marketplace, or unleash what is effectively a data dump on your customers."[63]

Why would corporations engage in a "data dump" that impedes understanding? The securities regulation regime that governs mandatory reporting of public companies, as well as most state corporate laws, provide significant immunity from fraud liability for comprehensive disclosure, even if the amount of disclosure arguably renders adequate understanding all but impossible.[64] Moreover, the uncertainty with respect to what socially responsible business practices entail may make it difficult to determine what information the corporation possesses and is apposite to consumer and investor concerns. A corporation acting in good faith might opt for excessive disclosure, because "[e]ven the most open and proactive firms face a dilemma: Too often they just don't know what they know.

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statement of the ultimate fact'" (quoting Kennedy v. Tallant, 710 F.2d 711, 720 (11th Cir. 1983) and noting that "[t]o find a disclosure inadequate under the 'buried facts' doctrine . . . there must be *some* conceivable danger that the reasonable shareholder would fail to realize the correlation and overall import of the various facts interspersed throughout the proxy"); Ballan v. Wilfred Am. Educ. Corp., 720 F. Supp. 241, 250–51 (E.D.N.Y. 1989) (endorsing the buried facts theory as supplying a cause of action for a shareholder who claims that a corporation "buried negative information in obscure parts of the *various reports* so that potential purchasers would overlook it") (emphasis added); Gould v. Am. Haw. Steamship Co., 331 F. Supp. 981, 996 (D. Del. 1971) (finding disclosures in a proxy insufficient because the "various facts listed previously [that] the defendants contend adequately reveal any conflict are interspersed throughout the proxy materials and could be gleaned *only through a close and prolonged perusal*") (emphasis added); *In re* MONY Group, Inc. Shareholder Litig., 852 A.2d 9, 24–25 (Del. Ch. 2004) (noting that under Delaware law corporate directors must disclose all material information but that the law does not require disclosure of "'speculative information [that] would tend to confuse stockholders or *inundate them with an overload of information*'") (emphasis added) (quoting Arnold v. Soc'y for Sav. Bancorp., 650 A.2d 1270 (Del. 1994); *see also Get Naked*, ECONOMIST, Oct. 18, 2003, at 66 (recognizing that absolute transparency in the corporate setting may not produce better corporations). *See generally* Mark Fenster, *The Opacity of Transparency*, 91 IOWA L. REV. 885 (2006) (questioning the fundamental normative assumption that transparency in the government, political, or corporate contexts results in efficient and overall better systems); Cass R. Sunstein, *Informational Regulation and Informational Standing:* Akins *and Beyond*, 147 U. PA. L. REV. 613, 618–33 (1999) (discussing the rise of informational regulation and questioning whether this regulation actually produces the most efficient state).

61. *See* Paredes, *supra* note 59, at 419.

62. *Id*.

63. POHLE & HITTNER, *supra* note 26, at 11.

64. *See* Paredes, *supra* note 59, at 421–30.

And when they do, they don't know what to share."[65] Regardless of the motives for the dissemination, communicating vast amounts of information can clearly inhibit understanding.

4. Corporate Silence

Taking an opposite tact, many corporations simply refuse to publish relevant information. Although companies may indeed disclose information to consumers and investors, complaints abound that companies too often hide the data essential to making an informed decision about the level of social responsibility embraced.[66] Since the content of social, ethical, and environmental reporting falls outside the ambit of most securities regulations and state disclosure laws, companies may be reluctant to expand disclosure in those areas. Reasons for such reticence "include fear of liability and lawsuit, particularly if disclosure reveals breaches of law, and concerns that competitors will have access to proprietary information. There are also concerns that companies could use environmental or social performance data to undercut competitors."[67] To the extent companies withhold the essential pieces of information necessary to make an adequate assessment of socially responsible business practices, consumers and investors are left foundering.

5. Greenwashing

Many suggest, however, than in an effort to appear socially grounded, corporations have engaged in "greenwashing" or promoting a false (or factually unsupported) image of social responsibility.[68] For instance, British Petroleum's advertised commitment to environmental safety faced serious accusations of greenwashing following the 2005 explosion at its Texas refinery and a 2006 oil spill from its Alaskan pipeline.[69] Taking

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65. POHLE & HITTNER, *supra* note 26, at 9.

66. *See* Williams, *supra* note 29, at 1291–92; *see also* James Farrar, *On Sustainability: HP CSR Report: A Triumph for Transparency*, ZDNET, Apr. 16, 2008, http://blogs.zdnet.com/sustainability/?p=123 (After praising Hewlett-Packard for disclosing negative information about its suppliers, noting "[t]he apparel industry tried to resist this for some time on the grounds that opacity of the supply chain was a key competitive advantage.").

67. ZARSKY, *supra* note 41, at 48.

68. William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253, 253–60 (2003); Thomas P. Lyon & John W. Maxwell, *Greenwash: Corporate Environmental Disclosure Under Threat of Audit*, Mar. 24, 2006, http://webuser.bus.umich.edu/tplyon/Lyon_Maxwell_Greenwash_March_2006.pdf.

69. Curtis V. Verschoor, *Is BP an Acronym for "Big Polluter"?*, STRATEGIC FIN., Sept. 2007, at 12.

another example, Greenpeace recently accused Hewlett-Packard of falsely claiming environmental credentials after failing to remove toxic chemicals from its production line.[70]

As SRI continues to grow, accusations of corporate greenwashing become more troublesome as well.[71] To the extent greenwashing persists, consumers and investors cannot effectively discern which companies actually embrace CSR. As a result, some companies that falsely, yet effectively, promote an image of CSR will enjoy undeserved benefits, while companies that honestly report CSR practices will find it more difficult (and arguably costly) to establish the authenticity of their socially responsible business practices.

Exacerbating the problem of greenwashing are corporate claims of free-speech rights.[72] With increasing vigor, corporations are mixing political commentary with otherwise commercial disclosures in an effort to render the amalgam of politically tinged commercial speech immune from liability or regulation under the First Amendment.[73] Because statements regarding CSR practices often touch inherently political matters, to the extent corporations successfully press their political speech claims, it becomes even more difficult to test the accuracy of corporate communications.[74]

6. Dilemmas and Tragedies

Two economic heuristic devices, the Prisoner's Dilemma and the Tragedy of the Commons, help clarify the transparency crisis that threatens the viability of CSR. In the first instance, consumers, investors, and corporations find themselves locked in a slight variation of a classic Prisoner's Dilemma.[75] In the classic case, prisoners awaiting trial may cooperate with each other by remaining silent about the crime committed

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70. *Greenpeace Accuses HP of Greenwash*, ZDNET.CO.UK., Feb. 19, 2007, http://news.zdnet.co.uk/hardware/0,1000000091,39237334,00.htm.

71. *See* David Kozlowski, *Greenwash Getting Harder to Clean Up*, BLDG. OPERATING MGMT., Mar. 2002, *available at* http://www.facilitiesnet.com/green/article.asp?id=1386.

72. *See* Michael R. Siebecker, *Building a "New Institutional" Approach to the First Amendment*, 59 ALA. L. REV. 247, 250–54 (2008).

73. *See id.*; *see also* Siebecker, *supra* note 9, at 621–26.

74. For a detailed discussion of the effect that granting full First Amendment protection to politically tinged corporate speech would have on the mandatory period reporting and disclosure requirements under the securities laws, see Siebecker, *supra* note 9, at 651–70.

75. For an interesting description of the Prisoner's Dilemma applied to CSR, see Note, *Finding Strategic Corporate Citizenship: A New Game Theoretic View*, 117 HARV. L. REV. 1957, 1959–66 (2004). *See generally* W. POUNDSTONE, PRISONER'S DILEMMA (1992) (providing a detailed description of the history and theoretical implications of the Prisoner's Dilemma).

or defect by testifying for the prosecution against the fellow accomplice. If one prisoner testifies and the other remains silent, the defecting prisoner receives no sentence and the prisoner who chose to remain silent receives a ten-year prison term. If both cooperate by remaining silent, each receives a short six-month jail term. If both defect by testifying against the other, however, each receives a five-year prison sentence.[76] Although the prisoners would be better served by cooperating rather than defecting given the relative payoffs, mutual defection represents the equilibrium position in a one time iteration of the game.[77] That result occurs, because for each player in the single game, defection likely provides greater rewards than cooperation. Studies demonstrate that if the game is played repeatedly, however, the ability to punish defecting behavior from one game to the next causes the equilibrium position to shift to mutual cooperation.[78]

In a slightly modified version of the Dilemma relevant to the tragedy of transparency, the cooperative postures entail corporations embracing, and reporting accurately, socially responsible business practices with consumers and investors purchasing the products or stock of compliant companies. In contrast, the defective postures entail corporations *not* embracing, and *not* reporting accurately, socially responsible business practices and consumers and investors *not* purchasing the products or stock of socially compliant companies.

Because corporations, consumers, and investors represent repeat players in continual iterations of the game over time (i.e., with each report of social compliance and every purchase of company products or stock), the equilibrium position should be mutual cooperation. But due to the various corporate communication failures described above, it is extremely difficult for consumers and investors to detect when a corporation adopts a defective posture. In essence, corporations can falsely report compliance with CSR standards without actually embracing those practices. So, rather than providing accurate and accessible information, corporations find an incentive to dissemble, thereby defecting from the cooperative equilibrium position that would produce authentic CSR and provide rewards to compliant companies. Of course, corporations do not enjoy complete immunity from detection. But if consumers and investors feel they are

76. *See* POUNDSTONE, *supra* note 75.

77. S. Le & R. Boyd, *Evolutionary Dynamics of the Continuous Iterated Prisoner's Dilemma*, 245 J. THEORETICAL BIOLOGY 258–67 (2007).

78. *Id.*

playing a rigged game, they too may refuse to cooperate. As a result, the mutual economic gains from CSR risk getting wasted.

In a second sense, current corporate communications regarding CSR practices resemble a *reverse* Tragedy of the Commons.[79] In a classic commons tragedy, public goods get over-consumed and eventually disappear because individuals fail to internalize fully the costs of consumption.[80] In the CSR context, the quality public information that would enable an effective CSR movement to thrive does not get over-consumed but instead gets lost in a vast over-*contribution* of information. Relevant and accessible data gets lost like a needle in a haystack. As a result, the public good of quality information gets destroyed.

Thus, the tragedy of transparency threatens the basic viability of CSR. Clearly, consumers, investors, and corporations alike have economic interests in sustaining the CSR movement. From the perspective of corporations, the increased (and, thus, less expensive) access to capital coupled with an ability to command higher product prices provide incentives for social responsibility. From the viewpoint of consumers and investors, the change in corporate practices provides greater utility than the increased stock or product price premium they would pay for corporate social compliance. Despite the mutual economic advantages of CSR, without more robust corporate transparency, the sustainability of the movement seems questionable.

III. ENCAPSULATED TRUST AND CORPORATE TRANSPARENCY

Given the systemic information failures that persist under the current federal and state regulatory regimes, can a concept of trust provide a useful framework for determining the disclosure obligations of corporations? Looking to that philosophical foundation should not seem terribly strange, considering the notion of trust lies at the core of corporate law.[81] After all, the basic fiduciary duties of care and loyalty place directors, officers, and certain controlling shareholders in a special relationship of trust with the corporation.[82] Operating through those

79. For a general review of various aspects of the classical Tragedy of the Commons, see Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243 (1968).

80. *Id.* at 1246.

81. *See* Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185–218 (Lawrence E. Mitchell ed., 1995); Eli Bukspan, *The Notion of Trust as a Comprehensive Theory of Contract and Corporate Law: A New Approach to the Conception That the Corporation is a Nexus of Contract*, 2 HASTINGS BUS. L.J. 229 (2006).

82. *See* Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U. L.

fiduciary duties, a bedrock sense of trust ensures all shareholders of a corporation, and perhaps other corporate constituencies, will have their interests taken into account by corporate decision makers.[83] Widely embraced in the common law and codified in most states,[84] the reach of that fundamental trust relationship continues to grow as courts and legislatures find new corporate contexts in which to extend those basic fiduciary duties. Whether regarding corporate philanthropy, shareholder disputes, director malfeasance, hostile takeovers, insider trading, CSR, or complex acquisition transactions, the notion of trust provides important guidance and limitations on a vast array of corporate actions.[85]

Although providing the backbone of modern corporate law,[86] the concept of trust might not seem particularly apposite when applied to issues of disclosure.[87] While maintaining a robust corporate enterprise may require a strong sense of trust to balance the rights and responsibilities of competing corporate actors and constituencies,[88] does trust really play such an essential (or even relevant) role in the context of corporate communications? Even if there were some nexus between disclosure and the philosophically disciplined account of encapsulated trust considered here,[89] that special account of encapsulated trust may differ fundamentally

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REV. 75, 98–120 (2005).

83. Mitchell, *supra* note 81, at 188–93; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1781–1807 (2001).

84. *See* Lyman Johnson, *Having the Fiduciary Duty Talk: Model Advice for Corporate Officers (and Other Senior Agents)*, 63 BUS. LAW. 147, 148 (2007) (stating that thirty-four states have codified officer fiduciary duties with the remaining states embracing those duties in common law doctrine); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1593–94 (2005) (describing the common law and statutory evolution of corporate fiduciary duties under state law).

85. Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 595 (1992).

86. *See* Mitchell, *supra* note 81, at 185–218; Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457, 1461 (2005) (discussing the essential role of trust in economic transactions); R. William Ide III & Douglas H. Yarn, *Public Independent Fact-Finding: A Trust-Generating Institution for an Age of Corporate Illegitimacy and Public Mistrust*, 56 VAND. L. REV. 1113, 1115–16 (2003) (describing the essential role public trust plays in corporate life).

87. *See, e.g.*, Harry S. Gerla, *Issuers Raising Capital Directly From Investors: What Disclosure Does Rule 10b-5 Require*, 28 J. CORP. L. 111, 121–22 (2003) (positing that reliance upon fiduciary trust duties creates intractable questions and disturbing outcomes for corporate disclosure in the context of securities sales); Geoffrey A. Manne, *The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure*, 58 ALA. L. REV. 473 (2007) (criticizing the existing regulatory framework for corporate disclosure for positing a theory of corporate communication obligations based on behavioral economic theory).

88. Faith Stevelman Kahn, *Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure*, 34 GA. L. REV. 505, 520–21 (2000).

89. *See infra* Part III.A–B.

from what currently undergirds corporate fiduciary duties. Therefore, answering whether a sense of trust can provide a useful framework for determining corporate disclosure obligations must begin by understanding how existing corporate fiduciary duties of trust relate to disclosure, if at all.

Examining that tie between disclosure and trust seems an especially important task, considering much of current corporate disclosure obligations (at least for public corporations) are mandated by federal securities laws and regulations.[90] That statutory backdrop may very well carve out disclosure obligations from the role trust plays in regulating corporate conduct or obligations. If that investigation reveals, however, that the extant fiduciary duties of officers and directors include—or are at least amenable to accommodating—duties of disclosure, then determining how a more robust and disciplined philosophical account of trust might inform the scope of that fiduciary duty of disclosure becomes quite useful. In the end, applying a concept of encapsulated trust to the fiduciary duties owed by directors and officers would arguably provide a means to escape the tragedy of transparency looming on the horizon.

A. *The Fiduciary Framework for Disclosure*

That directors and officers owe fiduciary duties of care and loyalty to the corporations they serve represents an uncontroversial proposition.[91] Memorialized in the state statutes that sanction the very existence of the corporate form and pepper the common law of business organizations in each jurisdiction,[92] those two fiduciary duties provide the basic safeguard to shareholders and other constituencies against unbridled opportunism and misconduct by those corporate managers.[93]

By design, the duties sustain and define an essential agency relationship that intends to prevent the actions of directors and officers

90. *See* Siebecker, *supra* note 9, at 651–71; Paredes, *supra* note 59, at 421–30.

91. Mary Szto, *Limited Liability Company Morality: Fiduciary Duties in Historical Context*, 23 QUINNIPIAC L. REV. 61, 86–105 (2005) (describing the evolution of corporate fiduciary duties from ancient times). *See generally* Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers are Fiduciaries*, 46 WM. & MARY L. REV. 1597 (2005); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002).

92. *See* Justice Joseph T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. CORP. L. 333, 333 (2002); *see also supra* note 84 and accompanying text.

93. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS FROM ENRON TO REFORM 246–310 (2006); Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 76–80 (2005) (discussing the evolution and basic role of fiduciary duties under corporate law).

from falling too far afield from the interests of those they serve.[94] The duties capture a sense of obligation, or a set of incentives, that dissuade corporate decision makers from shirking their responsibilities or pursuing personal goals at odds with the corporation.[95]

At the core of that agency relationship lies an essential concept of trust. After all, the very nature of a fiduciary relationship connotes a reliance on trust.[96] In essence, trust provides a sort of philosophical fuel that animates the duties and gives them an initial trajectory.[97] Beyond providing that first burst of definitional momentum, however, trust arguably plays a limited role in shaping the precise contours of corporate fiduciary duties. Although trust may provide an essential touchstone or starting point for grappling with the substantive content of corporate fiduciary duties, trust as currently construed in corporate law seems quite vague.[98] So even if trust represents the philosophical atom from which the force of corporate fiduciary duties emanates, the nature of that philosophical atom remains a bit of a mystery.[99]

Perhaps because the bedrock principle of trust remains rather amorphous as currently construed in corporate law, the precise shape of the fiduciary duties directors and officers owe remains a topic of significant contention.[100] Many assert that reliance on abstract concepts of

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94. *See* Edward B. Rock and Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV., 1619, 1626–27 (2001).

95. Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 646 (2004) ("To deter management malfeasance and to provide shareholders a remedy for managerial shirking or stealing, the law imposes on managers, as agents of the corporation, the fiduciary duties of loyalty and care."); Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 270–78 (1998); *see also* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.").

96. Richard N. Ottaway, *Defining Trust in Fiduciary Responsibilities*, *in* TRUST, RESPONSIBILITY, AND CONTROL: THE ETHICS OF ACCOUNTING & FINANCE 3 (W. Michael Hoffman et al. eds., 2000) ("In some ways, there is no role in fiduciary relationships other than trust."); Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 256–65 (2006); Lawrence E. Mitchell, *The Importance of Being Trusted*, 81 B.U. L. REV. 591, 614–17 (2001) (discussing the essential nexus between trust and fiduciary relationships). *See generally* Bukspan, *supra* note 81.

97. *See* Cross, *supra* note 86, at 1461 (positing in the context of economic transactions, "[w]hile we have a generalized understanding of the concept of trust, it is not readily amenable to clear definition."); *see also id.* at 1461 n.6 (listing a host of scholarly opinions regarding the ambiguity of trust in corporate law).

98. Blair & Stout, *supra* note 83, at 1747–53, 1780–89 (2001) (discussing the variety of conceptions of trust and their application in corporate law).

99. *See* Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 428 (1993) (discussing the "mystery" of fiduciary duties in corporate law).

100. MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 610 (1995) (suggesting

fiduciary duties results in a system of inconsistent and incoherent regulation of corporate behavior. According to critics, that duties of care and loyalty exist says precious little about the particular contexts in which those duties necessarily arise or the content of the duties in any circumstance.[101] For instance, when and to what extent does the duty of care require officers and directors to prevent unlawful activities from taking place at a company?[102] Would officers of a shipping company who knowingly permit company truck drivers to park illegally in order to make timely deliveries violate a duty of care? Would the fiduciary standard apply similarly to officers of a pharmaceutical company who knowingly acquiesced to salespeople providing illegal "kickbacks" to physicians for prescribing company products? For those skeptical of the ability to use fiduciary duties as organizing constructs in corporate law, the criticism seems not that the duties of trust provide no information about appropriate conduct of officers and directors, but instead that those broad philosophical concepts provide imprecise and spare guidance.[103] Rather than rely on vague fiduciary duties, opponents often suggest clear statutory mandates or negotiated contracts regarding the shape of those duties specific to each company.[104] By allowing the market to shape fiduciary duties through contract, the goal remains a more efficient regulatory regime.

Of course, proponents of trust and fiduciary duties meet their critics head on. Often using instances of corporate excess and scandal as ample

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fiduciary standards remain extremely vague in corporate law); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 879 (1988) (describing trust based fiduciary duties as "elusive concepts"); Duggin & Goldman, *supra* note 96, at 263 n.334 (2006) (stating the courts have had difficulty defining the precise nature of corporate fiduciary relationships).

101. *See* Smith, *supra* note 91, at 1411–15 (discussing the indeterminacy in construing fiduciary duties by courts); *see also* Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1320 (2008) (arguing that fiduciary duty obligations seem inconsistently applied).

102. The example targets the basic issue of a duty to monitor corporate malfeasance raised in *In re Caremark Int'l Inc. Derivative Litig*., 698 A.2d 959 (Del. Ch. 1996). For a detailed discussion of the case, *see* Hillary A. Sale, *Monitoring* Caremark*'s Good Faith*, 32 DEL. J. CORP. L. 719 (2007).

103. *See* Smith, *supra* note 91, at 1411–15; *supra* notes 98–102 and accompanying text; *see also* Stuart R. Cohn, *Corporate Natural Law: The Dominance of Justice in a Codified World*, 48 FLA. L. REV. 551, 559 (1996) (suggesting that inherent vagueness of fiduciary duties causes courts to rely on basic equity principles to determine breaches of care).

104. *See* Baird & Henderson, *supra* note 101, at 1314–15 ("Our understanding of capital structures is simply too primitive for us to do much more than enforce the contracts that are written as best we can. The default rules we devise—and fiduciary obligations are simply one of these—should be in service of these contracts.") (citations omitted); Remus D. Valsan & Moin A. Yahya, *Shareholders, Creditors, and Directors' Fiduciary Duties: A Law and Finance Approach*, 2 VA. L. & BUS. REV. 1, 14–17 nn.46–47 (2007) (discussing various alternative approaches to a standard fiduciary duty framework for regulating corporate actors).

fodder, advocates of reinvigorated fiduciary duties attempt to putty the cracks in the increasingly distressed moral foundations of corporate law.[105] Rather than emphasizing regulatory efficiency or market preferences, proponents of fiduciary duties cite the need for corporate integrity and great attention to the constituencies corporations serve.[106] While the approaches remain quite diverse, some commonality cuts across the spectrum. For many, the failure to make trust central to corporate life causes, or at least permits, corporate scandals to recur.[107] Sympathetic scholars, judges, and even market professionals describe the need for enhanced trust in corporate governance and its particular application in the instances considered.[108] Rather than providing a detailed, methodological defense of a particular philosophy of trust that the law should embrace,[109] many advocates of trust focus on the effects that the absence of trust causes and the benefits enhanced trust would create in corporate life. The absence of a more basic methodological discussion does not betoken a fundamental flaw in the analysis. Instead, it simply further fuels the debate about whether trust remains too malleable to solve the corporate problems identified.[110] In light of the debate about the role trust and fiduciary duties should play in regulating corporate conduct, the relationship between disclosure and existing fiduciary duties remains somewhat unclear.

Complicating the matter further is the role that the securities regulation regime plays in regulating corporate disclosure obligations. Through a variety of statutes, rules, and regulations, the securities laws provide a

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105. *See* William W. Bratton, *Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty*, *in* PROGRESSIVE CORPORATE LAW 139–85 (Lawrence M. Mitchell ed., 1995); JERRY W. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS FROM ENRON TO REFORM, 246–310 (2006); David M. Walker, *Restoring Trust After Recent Accountability Failures*, *in* GOVERNING THE CORPORATION 21–47 (Justin O'Brien ed., 2005).

106. *See, e.g.*, *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility*, 54 MERCER L. REV. 789, 790–92 (2003) (reasoning that corporate responsibility springs, at a minimum, from the exercise of fiduciary duties, and this corporate responsibility leads to public trust in corporate integrity).

107. *See* Duggin & Goldman, *supra* note 96, at 256–73.

108. *Id*. at 273–74. *See generally* JAY WILLIAM LORSCH, LESLIE BERLOWITZ & ANDY ZELLEKE, RESTORING TRUST IN AMERICAN BUSINESS (2004).

109. While there are many proposals to address specific issues within the trust framework, see, for example, Lawton W. Hawkins, *Exchange-Enhanced Special Litigation Committees: Enforcing Fiduciary Duties Amid a Crisis of Trust*, 2003 UTAH L. REV. 587, 589 (2003) ("[D]erivative suits can play a role in restoring trust in the officers and directors of U.S. corporations", they focus on the tools to attempt to create or restore that trust and not to the nature of trust in the corporate context.).

110. *But see* Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1779–96 (2006) (examining corporate scandals and governance under a cognitive theory of trust).

framework for mandatory, periodic disclosures by public companies.[111] Whether in the context of quarterly or annual reports, securities offerings, proxy solicitations, or a host of other public communications, the securities laws establish an integrated and uniform disclosure system to ensure consumers and investors receive reliable information, both quantitative and qualitative, to inform their decisions.[112] The network of laws provides differing degrees of fraud liability that change depending on the context.[113] Taken as a whole, those various levels of fraud protection attempt to strike a balance between satisfying the public's need for accurate business data and providing sufficient incentives (with reward or penalty) for corporations to disseminate that information.[114]

The concern with the securities laws centers on preemption of state statutory or common law disclosure duties. To the extent that the vast disclosure duties embedded in the federal securities laws entirely preempt conflicting (or more strenuous) state laws, the basic relevance of any nexus between disclosure and corporate fiduciary duties hangs in the balance.[115] Without question, the federal securities laws intend to provide some uniformity regarding the sale of securities.[116] The Securities Litigation Uniform Standards Act of 1998 (the "Uniform Standards Act")[117] preempts a variety of state law securities actions and requires them to be brought in federal court. The Uniform Standards Act, however, does not preempt exclusive derivative actions brought by shareholders on behalf of the corporation, including claims based on the sale of securities involving corporate communications regarding stockholder voting rights, appraisal rights, dissenting rights, or responses to tender offers.[118] Moreover, pursuant to the "internal affairs" doctrine, the securities laws

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111. *See*, *e.g.*, 15 U.S.C. § 77e (2000); 17 C.F.R. § 229.10 (2006); 17 C.F.R. §§ 243.100–.103 (2006). *See generally* Siebecker, *supra* note 9.

112. *See* Siebecker, *supra* note 9, at 641–42.

113. *Id*. at 661–62.

114. *See* Herbert S. Wander, *Securities Law Disclosure After Sarbanes-Oxley*, SN071 A.L.I.-A.B.A. 797 (2008) ("The primary issue to focus on when reading these proposals is whether they effectively balance the goal of encouraging broader dissemination of forward looking information to the investing public without compromising investor protection by sanctioning fraudulent or recklessly prepared forecasts.").

115. *See* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 57–60 (1989) (highlighting scholarly discussion of preemption spanning from the 1950s to the 1980s). *See generally* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273 (1998).

116. *See* Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors' and Officers' Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1190 n.139 (2006).

117. Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

118. 15 U.S.C. § 77p(d)(1)(B)(ii)(II) (Supp. 2006).

generally do not preempt issues of corporate governance arising under state law.[119] Despite the broad mandatory disclosure obligations detailed in the federal securities laws, some room exists for fiduciary disclosure duties based on state law.

Delaware provides the most prominent example of a robust duty of disclosure based on state law fiduciary duties.[120] Under Delaware law, the duties of loyalty and good faith that directors and officers owe require full and accurate communication with shareholders. For some time, Delaware has embraced a duty of full disclosure on matters requiring shareholder action.[121] In *Malone v. Brincat*,[122] however, the Delaware Supreme Court announced a much broader disclosure duty that encompasses general corporate communications with shareholders, even when the communications touch upon matters regulated by the federal securities laws.

In *Malone*, shareholders of a publicly traded Delaware corporation alleged that company directors breached their state law fiduciary duty of disclosure by filing false financial reports with the SEC and routinely communicating false information to shareholders regarding the company's financial condition.[123] Although upholding the lower court's dismissal of the complaint, the Delaware Supreme Court held that "Delaware law also protects shareholders who receive false communications from directors even in the absence of a request for shareholder action. When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation . . . there is a violation of fiduciary duty."[124] Describing the duty of disclosure as

119. *See* Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1997) (refusing to federalize all corporate law regarding transactions in securities); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 597 (2003) (describing the "internal affairs" doctrine that informally limits the scope of federal authority from extending to state governance issues).

120. Dana M. Muir & Cindy A. Schipani, *The Use of Efficient Market Hypothesis: Beyond Sox*, 105 MICH. L. REV. 1941, 1957–58 (2007).

121. S*ee, e.g.*, Stroud v. Grace, 606 A.2d 75 (1992); *see also* Lawrence A. Hamermesh, *Calling Off the* Lynch *Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1174 n.394 (1996).

122. 722 A.2d 5 (Del. 1998).

123. *Id*. at 8.

124. *Id*. at 14; *see also* Jackson Nat'l Life Ins. Co. v. Kennedy, 741 A.2d 377, 390 (Del. Ch. 1999):

> It necessarily follows from *Malone* that when directors communicate with stockholders, they must recognize their duty of loyalty do so with honesty and fairness, regardless of the stockholders' status as preferred or common, and regardless of the absence of a request for action required pursuant to a statute, the corporation's certificate of incorporation or any bylaw provision.

Jackson, 741 A.2d at 390.

"complementary" to federal disclosure mandates and citing the Senate Committee Report on the Uniform Securities Act that explicitly recognized the import of state law disclosure duties,[125] the Delaware Supreme Court established a substantial platform for a disclosure duty independent of federal standards.

Despite the broad disclosure duty articulated by the Delaware Supreme Court, debate persists regarding its scope, application, and usefulness as a means of organizing corporate behavior.[126] The concerns expressed are certainly not limited to the realm of corporate disclosure duties but appear generally whenever common law standards play a significant role. Why? Although organic common law standards can necessarily adapt more quickly than formal legislative initiatives to evolving corporate practices,[127] the very flexibility also sparks concerns about indeterminacy.[128] Rather than remaining tethered to a coherent set of principles capable of consistent application over a range of circumstances, standards risk drifting from one case to the next. A concern over the potential arbitrariness and inconsistency in the application of common law fiduciary standards should arise, however, only if an insufficiently sound set of principles exists upon which to base those duties. To the extent a robust and detailed philosophical framework supports the articulation of common law fiduciary standards, concerns over indeterminacy should wane. Moreover, at least in the case of a fiduciary duty of disclosure based

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125. *See Malone*, 722 A.2d at 13 n.42 (1998) (quoting S. Rep. No. 105-182, at 11–12 (May 4, 1998)) ("The Committee is keenly aware of the importance of state corporate law, specifically those states that have laws that establish a fiduciary duty of disclosure.").

126. *See*, *e.g*., Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1 (2005); Kahn, *supra* note 88; Mark Klock, *Lighthouse or Hidden Reef? Navigating the Fiduciary Duty of Delaware Corporations' Directors in the Wake of Malone*, 6 STAN. J.L. BUS. & FIN. 1 (2000); Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475 (2002).

127. For a general discussion of the advantages of common law standards over statutory initiatives in responding to changing practices, see Michael R. Siebecker, *Cookies and the Common Law: Are Internet Advertisers Trespassing on Our Computers?*, 76 S. CAL. L. REV. 893 (2003).

128. For concerns regarding deference to common law standards in corporate law, see, for example, Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 601–02 (2002); Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85 (1990); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205 (2001); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998); David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127 (1997).

on encapsulated trust, the flexibility of the common law duties necessarily enhances the likelihood that efficient corporate practices will result.[129]

B. Encapsulated Trust Revitalized

A revitalized sense of trust could provide a means to escape the tragedy of transparency that threatens the viability of CSR. As the prior section established, the hodgepodge of perverse incentives currently influencing corporate behavior, and systemic information failures that undermine the ability of shareholders and other constituencies to make sense of corporate communication, seem at least amenable to correction through an enhanced emphasis on a fiduciary duty of disclosure. That the existing legal landscape can accommodate a corporate disclosure obligation based on common law fiduciary duties represents a necessary, but certainly not a sufficient, defense of such a disclosure duty. Articulating a philosophically robust sense of trust upon which to build a coherent duty of disclosure represents the task ahead.

The goal, however, is not really to advocate adoption of a particular kind of trust. Instead, the project remains a limited *conditional* investigation. Rather than defending one concept of trust as necessarily superior to all other potential accounts, the aim is to explicate with philosophical rigor a particular type of trust and then to explore the ramifications of employing that sense of trust to support a fiduciary duty of disclosure. In essence, this Article takes a particular philosophy of trust for a "test drive" and determines whether that disciplined sense of trust could alleviate the disclosure failures currently plaguing corporate law and business practices. The conditional methodology should make the project at hand seem quite modest and uncontroversial in scope—for the arguments advanced here cannot effectively rule out other notions of trust that might provide equal or even greater benefits. What the conditional methodology does demonstrate, however, is the usefulness of at least one disciplined and philosophically rigorous account of trust in articulating the foundations of common law disclosure duties. And even with that limited reach, the project may still provide a means to preserve the basic viability of CSR.

With the conditional nature of the project firmly understood, what sense of trust might allow corporations, consumers, and investors to escape the tragedy of transparency currently afflicting corporate

129. *See infra* Part IV.A.

communication? Although many disparate notions of trust exist,[130] the concept of "encapsulated trust"[131] seems to possess a potentially significant connection to corporate law generally and corporate disclosure obligations in particular. In simple terms, encapsulated trust constitutes a rational expectation that others will take our interests into account when determining what course of action to pursue.[132] The contours of encapsulated trust remain rather malleable, however, and change depending upon the context within which encapsulated trust occurs.[133] While the most basic form of encapsulated trust manifests itself in interpersonal relationships,[134] encapsulated trust extends to institutions as well.[135] Properly understanding what encapsulated trust entails, then, requires an appropriate examination of how the nature of encapsulated trust changes in each context.

An examination of those contexts reveals that encapsulated trust may provide a basis for constructing a general theory of corporate disclosure duties, though perhaps not a useful tool for understanding the proper contours of corporate speech rights in every conceivable context. Nevertheless, encapsulated trust still represents a potentially powerful analytical principle to understand the proper limitations of corporate communications. That usefulness depends on the deep-seeded role that

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130. *See, e.g.*, Valerie Braithwaite, *Communal Exchange Trust Norms: Their Value Base and Relevance to Institutional Trust*, *in* TRUST & GOVERNANCE 46 (1998) (Valerie Braithwaite & Margaret Levi eds., 1998) (describing trust as a product of shared social values); Phillip Pettit, *Republican Theory and Political Trust*, *in* TRUST & GOVERNANCE 295 (1998) (Valerie Braithwaite & Margaret Levi eds., 1998) (linking notions of trust to civic political theory); ROBERT C. SOLOMON & FERNANDO FLORES, BUILDING TRUST IN BUSINESS, POLITICS, RELATIONSHIPS, AND LIFE 7 (2001) (characterizing trust as an emotional skill that arises in the context of a variety of dynamic, ongoing relationships); Tom R. Tyler & Roderick M. Kramer, *Whither Trust*, *in* TRUST IN ORGANIZATIONS 5–7 (Roderick M. Kramer & Tom R. Tyler eds., 1996) (setting forth various social conceptions of trust rooted in moral psychology); ERIC M. USLANER, THE MORAL FOUNDATIONS OF TRUST (2002) (arguing that trust represents a moral commitment independent of personal interactions); Cross, *supra* note 86, at 1461 (articulating a concept of trust based on cognitive and emotional affect); O.E. Williamson, *Calculativeness*, *Trust, and Economic Organization*, 34 J.L. & ECON. 453, 453–86 (1993) (advancing trust as a product of rational expectation of future cooperation).

131. Although a variety of trust scholars embrace a similar account of trust, the encapsulated interest account of trust is generally attributed to Russell Hardin. *See* RUSSELL HARDIN, TRUST (2006); RUSSELL HARDIN, TRUST AND TRUSTWORTHINESS (2002) [hereinafter HARDIN, TRUSTWORTHINESS]; Russell Hardin, *Distrust: Manifestations and Management*, *in* DISTRUST 3–33 (Russell Hardin ed., 2004) [hereinafter Hardin, *Distrust*]; Russell Hardin, *Trusting Persons, Trusting Institutions*, *in* THE STRATEGY OF CHOICE 185 (Richard J. Zeckhauser ed., 1991).

132. KAREN S. COOK ET AL., COOPERATION WITHOUT TRUST? 5–6 (2005).

133. *Id.* at 104–87 (detailing various institutional and state contexts within which encapsulated trust plays a role).

134. *Id*. at 5; Hardin, *Distrust*, *supra* note 131, at 6.

135. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 20–26.

trust already plays in the corporate realm.[136] And at least within that peculiar setting, the concept of trust seems to provide some guidance on how to avoid the tragedy of transparency currently threatening the CSR movement.

Understanding the role that encapsulated trust might play in assessing the appropriate level of corporate disclosures requires setting forth what that particular account of trust entails. In common discourse, the concept of trust does not seem terribly baffling. Whether appearing in common slogans such as "In God We Trust" or used in casual conversation, trust plays an almost mundane role in shaping our ordinary relationships and expectations.[137] We trust our friends not to betray important confidences, teachers trust their students not to cheat on exams, and even some voters (perhaps unwisely) trust that candidates will deliver on promises made during election campaigns.[138] Rather than existing as some abstruse principle, then, trust seems to represent a sentiment with which we all have some innate affinity or shared experience.[139] Although we may not articulate explicitly the definition of trust upon which we rely, the meaning of trust seems intelligible enough for us to embrace it as part of our daily lives.[140]

On a more analytical level, however, trust seems somewhat difficult to pin down. At the outset, disagreement abounds regarding at what level of human interaction trust occurs.[141] While some suggest that trust can only be understood as a relationship between familiar individuals,[142] others suggest that a robust sense of social or communal trust pervades society as well.[143] In addition, there is little consensus with respect to what features mark the core characteristics of trust. According to some interpretations, for example, taking a personal risk represents a defining element of trust, while certain alternative approaches deny that any meaningful connection

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136. *See supra* notes 81–86 and accompanying text.

137. *See* SOLOMON & FLORES, *supra* note 130, at 3–15.

138. *Id.*

139. *See* MARTIN HOLLIS, TRUST WITHIN REASON 10–11 (1998); SOLOMON & FLORES, *supra* note 130, at 3–15.

140. *See* USLANER, *supra* note 130, at 1–13 (describing trust as the "chicken soup of social life").

141. William W. Bratton, *Never Trust a Corporation*, 70 GEO. WASH. L. REV. 867 (2002); *see also* Joan MacLeod Heminway, *Sex, Trust, and Corporate Boards*, 18 HASTINGS WOMEN'S L.J. 173, 179–85 (2007) (discussing various interpersonal levels at which trustworthiness takes shape).

142. *See, e.g.*, Bernard Williams, *Formal Structure and Social Reality*, *in* TRUST: MAKING AND BREAKING SOCIAL RELATIONS (D. Gambetta ed., 1988).

143. *See, e.g.*, Valerie Braithwaite, *Communal and Exchange Trust Norms: Their Value Base and Relevance to Institutional Trust*, in TRUST AND GOVERNANCE 49, 65 (V. Braithwaite & M. Levi eds., 1998).

exists between risk and trust.[144] While one conception focuses on the expectation of reciprocity,[145] another asserts that trust is simply an ethical demand for individuals to be "taken seriously" by others.[146] Refusing to adopt any single position on the appropriate scope and definition of trust, Professor Margaret Levi contends that "[t]rust is not one thing and does not have one source; it has a variety of forms and causes."[147] Regardless of the credibility of that protean account, Levi's approach perhaps at least underscores the notion that a fundamental lack of consensus exists with respect to what trust entails.

Considering the variety of meanings attributed to the concept of trust, a pointed examination of the potential nexus between trust and corporate disclosure duties requires specifying at the start exactly which particular conception of trust is at stake. Of course, selecting one definition of trust among many competing alternatives necessarily limits the scope of the examination and, perhaps, the significance of the conclusions drawn. But unless the intent is to provide a general survey of the potential connections between corporate law and all extant notions of trust,[148] drifting from one conception of trust to another would only lead to muddy analysis. And the intent here is not to provide some broad semantic survey. Instead, the goal is to trace the relationship, if any, between one specific construction of trust and corporate disclosure obligations.

So rather than wading through all the manifold meanings of trust, this analysis focuses on the connections between corporate fiduciary duties and the particular concept of encapsulated trust. With the selection of the concept of trust out of the way, explicating the contours of encapsulated trust represents the obvious next step in the investigation.

1. Tenets of Encapsulated Trust

The basic characteristics of encapsulated trust are borrowed in large part from an account developed by noted philosopher Russell Hardin. Although a proper understanding of the nature and import of encapsulated

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144. For a conception of trust that requires a sense of personal risk, see Philip Pettit, *The Cunning of Trust*, 22 PHIL. & PUB. AFF. 202, 204, 208 (1995). For an account of trust that denies the importance of risk, see OLLI LAGERSPETZ, TRUST: THE TACIT DEMAND 3 (1998).

145. *See, e.g.*, MARTIN HOLLIS, TRUST WITHIN REASON 144–50, 159 (1998).

146. *See, e.g.*, OLLI LAGERSPETZ, TRUST: THE TACIT DEMAND 156–57 (1998).

147. Margaret Levi, *A State of Trust*, *in* TRUST AND GOVERNANCE 79 (V. Braithwaite & M. Levi eds., 1998).

148. For a brief survey of various theoretical accounts of trust and their potential pitfalls, however, see Russell Hardin, *Conceptions and Explanations of Trust*, *in* TRUST IN SOCIETY 3–36 (Karen S. Cook ed., 2001) [hereinafter Hardin, *Explanations*].

trust goes somewhat further than what Hardin describes (as discussed below),[149] Hardin's initial construction provides a proper starting point. For using Hardin's account as a philosophical springboard helps identify certain core characteristics, which when construed more broadly, potentially sustain some meaningful connection between encapsulated trust and the standards for corporate disclosures of social information.

First, encapsulated trust represents a special agency relationship.[150] That agency relationship exists to the extent that we expect those in whom we place our trust to take our interests into account when determining how to act.[151] Thus, in order for me to trust another person according to the encapsulated interest account, I must expect that the person I trust remains somehow bound by her own motives to protect or advance my particular interests. Although the description of the characteristics of encapsulated trust that follow more fully flesh out the kind of interests at stake and the nature of the expectations involved, the concept of agency provides a useful heuristic for understanding the proximity or privity that encapsulated trust requires. After all, the essential characteristic marking the existence of an agency relationship, at least in legal terms, is an explicit or implicit grant of authority to act on another's behalf.[152] To the extent encapsulated trust represents an agency relationship, that sense of trust necessarily involves vesting in others the authority to act on my behalf.

Second, trust represents a three-part relationship.[153] Rather than simply existing as some nebulous emotion unattached to particular circumstances, trust as encapsulated interest exists when "A trusts B to do x (or with

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149. *See supra* notes 131–35 and accompanying text.

150. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 10–13; Russell Hardin, *Trust in Government*, *in* TRUST AND GOVERNANCE 12–13 (V. Braithwaite & M. Levy eds., 1999) [hereinafter Hardin, *Trust in Government*].

151. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 10; *see also* Russell Hardin, *Do We Want Trust in Government?*, *in* DEMOCRACY AND TRUST 26 (Mark E. Warren ed., 1999) [hereinafter Hardin, *Do We Want Trust in Government?*]:

> To say that I trust you with respect to some matter means that I have reason to expect *you to act in my interest* with respect to that matter because you have good reasons to do so, *reasons that are grounded in my interest.* In other words, to say that I trust you means I have reason to expect you to act, for your own reasons, *as my agent* with respect to the relevant matter. Your interest encapsulates my interest.

Hardin, *Do We Want Trust in Government?*, *supra* note 147, at 26.

152. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2008).

153. HARDIN, TRUST, *supra* note 131, at 7, 9–10. *But see* Hardin, *Explanations*, *supra* note 148, at 13–16 (discussing conceptions of trust based on a two-part relationship taking the form, for example, "I trust her".).

respect to x)."[154] The point of this construction is to make clear that our trust remains tethered to specific situations. In other words, the expectations upon which encapsulated trust relies vary depending on the particular circumstances at hand. To use Hardin's example, "I trust you to return the money for your morning cup of coffee, but I might not trust you with an unsecured loan of thousands of dollars for your down payment on a house."[155] Encapsulated trust, then, requires some attentiveness to particularity, to the circumstances within which people find themselves situated at any given time.[156]

Third, rational expectation plays an essential role in encapsulated trust.[157] Although Hardin's articulation of the basic agency relationship makes clear that encapsulated trust depends on individual expectations of another's motives,[158] Hardin takes great pains to underscore that trust as encapsulated interest requires much more than "reasonable factual expectation."[159] Trust cannot simply manifest itself through inductive reasoning about the effects of the actions of others. Unless we expect that others take our interests into account in determining how to act, we cannot trust them, despite great certainty that their actions will comport with our interests in the end.[160] Were trust simply to manifest itself through an ability to predict how others might act, nothing would distinguish trust from expectation itself.[161] For example, though I may predict confidently that *The New York Times* will publish a paper each day, I cannot properly describe that expectation as trust unless I believe the *Times* took my particular interests into account in following that course of action. Unlike simple expectation, encapsulated trust relies on my expectation that others will act motivated in part by my particular interests.[162]

Although the encapsulated interest account of trust clearly relies on a special kind of rational expectation, it seems wrong to propose that encapsulated trust involves something beyond rational expectation.[163] Properly construed, encapsulated trust is limited to a special subset within the universe of potential rational expectations. Only those expectations

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154. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 26.
155. *Id.*; *see also* HARDIN, TRUST, *supra* note 131, at 9–10.
156. COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 8.
157. HARDIN, TRUST, *supra* note 131, at 7–9.
158. *See id.*; *see also* COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 8.
159. HARDIN, TRUST, *supra* note 131, at 13–14.
160. *Id.*
161. *Id.*
162. *See* COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 6–7.
163. *See* Hardin, *Explanations*, *supra* note 148, at 20; Hardin, *Trust in Government*, *supra* note 150, at 14–16.

that touch upon the motivations of others suffice to support my trust in another.[164] While encapsulated trust may indeed depend on rational expectations of a certain sort, nothing beyond rational expectation (such as blind hope, belief in God, etc.) can sustain trust.[165] Therefore, Hardin's claim that it is wrong to construe trust as "nothing more than the reasonable factual expectation that another will behave in a relevant manner" seems somewhat flawed.[166] In a very real sense, not only is encapsulated trust nothing more than reasonable factual expectation, it is even less. Encapsulated trust cannot exist without rational expectation and only a special subset of rational expectations suffices to support expressions of trust.

Fourth, the interests and motivations necessary to support encapsulated trust occupy a broad range of rational and non-rational concerns.[167] At first blush, this may seem at odds with the rational expectation requirement just discussed. But no such incompatibility really exists. Encapsulated trust manifests itself as a reasonable expectation that those in whom I place my trust take my interests into account in determining how to act.[168] But my interests and the reasons another may have to act in accord with my interests need not be restricted to purely rational concerns. Emotional, religious, or a host of other non-rational interests and motivations could support a robust sense of encapsulated trust.[169] As Hardin explains, trust exists

> if A expects B to do x because B has a reason to do it that is grounded in A. That reason could be an ongoing relationship—including love, friendship, or mere exchange, as in business—a relationship with A that B wants to maintain. Or it could be some other interest B has that A somehow influences. For example, A may influence B's prospects for re-election.[170]

Remember that the essential component is that I reasonably expect that you will act in a certain way because you take my interests into account. The nature of those interests and the reasons you give for acting in a

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164. HARDIN, TRUST, *supra* note 131, at 13–14.

165. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 14–16.

166. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 25.

167. HARDIN, TRUST, *supra* note 131, at 5 ("A fully rational analysis of trust would depend not solely on the rational expectations of the truster but also on the *commitments*, not merely the regularity of the trusted."); HARDIN, TRUSTWORTHINESS, *supra* note 131, at 20–21.

168. HARDIN, TRUST, *supra* note 131, at 23.

169. *Id.*; *see also* Hardin, *Trust in Government*, *supra* note 150, at 24–25.

170. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 26.

certain way need not be rationally based as long as I can reasonably expect you to take into account my (rational or non-rational) interests in your (rational or non-rational) determination of how to behave.[171]

Fifth, the motivations and interests sufficient to support trust as encapsulated interest need not be based on close or continuing personal relationships.[172] Again, encapsulated trust simply requires a reasonable expectation that another will take my interests into account in determining what course of action to pursue. As long as some rational basis exists for my expectation that my interests will motivate your behavior, we need not share any sense of kinship or enjoy ongoing experiences in order for trust between us to occur.[173] In dismissing the notion that encapsulated trust requires "thick" relationships between individuals, Hardin states

> it is not true that the relevant expectations can be grounded only in thick relationships. I can expect you to act well as my agent for the reason that you will suffer loss if you do not. This can happen because of the iterated nature of our interaction, as in the thick-relationship model, or because of reputational effects that will enable you to benefit from relationships other than ours, or because there is an imposed structure of incentives to get you to act well as my agent.[174]

Thus, the interests and motivations necessary to support encapsulated trust need not satisfy any terribly onerous conditions. Of course, the strength of encapsulated trust might increase to the extent we share a closer relationship or the interests at stake seem more firmly supported by sound reasoning.[175] But at a fundamental level, as long as I can reasonably expect you will take into account my interests in determining how to act, encapsulated trust may still thrive.

Sixth, encapsulated trust requires a certain competence to assess the viability of the trust relationship.[176] At least for those who impart trust, unless we possess sufficient capability to judge the actions and motivations of others, we cannot effectively sustain a sense of trust as encapsulated interest.[177] Why? Initially, the very articulation of

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171. HARDIN, TRUST, *supra* note 131, at 58–60.

172. *Id.* at 21–23; Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 26.

173. HARDIN, TRUST, *supra* note 131, at 21–23.

174. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 27.

175. HARDIN, TRUST, *supra* note 131, at 23.

176. Hardin, *Explanations*, *supra* note 148, at 6–7; COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 5–6.

177. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 28.

encapsulated trust depends on our ability to assess whether or not others will be motivated to take our interests into account.[178] And once we impart trust in others, the maintenance of that trust requires us to assess whether or not the actions of others have undermined or fulfilled our expectations. Although encapsulated trust does not mandate that we have perfect information prior to imparting our trust or negate our ability to trust to the extent we make inaccurate factual assessments regarding the motivations and actions of others,[179] trust as encapsulated interest cannot exist as pure emotion.[180] Encapsulated trust represents informed choice. If we do not possess the competence to judge the actions and motivations of others—whether based on lack of information, insufficient expertise, or some other defect in our capacity—we simply cannot manifest or sustain a sense of trust in others according to the encapsulated interest account.[181]

In a similar manner, trust as encapsulated interest requires a degree of competence from those in whom we place our trust.[182] Looking back at the general description of encapsulated trust as an agency relationship helps illustrate the point.[183] When others act as our agents, they need some degree of proficiency to carry out our interests. As Hardin simply states, "[i]f A is to trust B, then B must have not only the motivation to do x but also the competence. An agent who cannot act on my behalf is a poor agent."[184] Absent some basic competence in pursuing a particular course of action, no matter how much another's motivations are grounded in my interests, that person simply cannot effectively bear my trust.

Although Hardin does not articulate the connection fully, the notion of competence serves as a necessary companion to the rational expectation component of encapsulated trust. As previously mentioned, trust as encapsulated interest requires a rational expectation that others will take into account my interests in determining how to act.[185] In essence, competence serves as the threshold standard for establishing what minimal rationality really requires. Without sufficient knowledge about another's motivations or actions—or the ability to process available information in

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178. HARDIN, TRUST, *supra* note 131, at 7–9.
179. *Id.* at 58–60; Hardin, *Trust in Government*, *supra* note 150, at 20–25.
180. HARDIN, TRUST, *supra* note 131, at 68–80.
181. *Id*. at 7–8; Hardin, *Trust in Government*, *supra* note 150, at 22–24.
182. HARDIN, TRUST, *supra* note 131, at 7–8.
183. *See supra* notes 150–51 and accompanying text.
184. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 28.
185. *See supra* notes 156–61 and accompanying text; *see also* Hardin, *Explanations*, *supra* note 148, at 15.

some intelligible manner—a person simply lacks the necessary foundation for trusting another according to the encapsulated interest account.[186]

In some sense, though, the criterion of competence seems a bit superfluous if the expectations necessary to support encapsulated trust must truly be rational. After all, how could expectations be rational if not based on minimally sufficient information and logical analysis? What competence attempts to capture is a sense of reasonableness that elevates somewhat the threshold for trust above the mark set by mere rationality.[187] While it may be rational (in some very limited sense of minimally plausible) for me to expect another to take my interests into account given a limited set of available facts, that rational expectation may not suffice to support encapsulated trust if those facts are somehow too flimsy or my analysis too strained. What encapsulated trust requires—through the criterion of competence—is a more robust sense that my expectation is reasonable under the circumstances. Competence thus addresses the level of confidence we might reasonably possess in our rational expectations.[188] Of course, appealing to a sense of practical reason (or reasonableness under the circumstances) provides no greater precision than rationality in determining what actually suffices to support encapsulated trust. Still, competence perhaps secures a higher quality of knowledge and judgment than what mere rationality requires.

Although Hardin sets forth the basic characteristics of encapsulated trust, an understanding of trust as encapsulated interest arguably goes well beyond what Hardin describes. In particular, while Hardin generally confines the concept of trust as encapsulated interest to interpersonal relationships,[189] individuals may manifest encapsulated trust in institutions,[190] including corporations. Understanding how trust as encapsulated interest extends to institutions, however, requires building on the basic mechanics of encapsulated trust in less abstract contexts.

In its elementary form, encapsulated trust exists as a simple interpersonal relationship. Clearly, that simple interpersonal relationship represents the primary focus of Hardin's construction of encapsulated trust. Recall that a Hardin trust exists as a three-part relationship where "A trusts B to do x (or with respect to x)."[191] To the extent we can rationally

186. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 10–11.

187. HARDIN, TRUST, *supra* note 131, at 21–24, 58–68.

188. COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 6–7.

189. HARDIN, TRUST, *supra* note 131, at 21.

190. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 15–19; Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 25–28; Hardin, *Trust in Government*, *supra* note 150, at 15–17.

191. Hardin, *Do We Want Trust in government?*, *supra* note 151, at 26; *see supra* notes 152–53

expect others to take into account our interests in determining what course of action to pursue, we can meaningfully describe that relationship as encapsulated trust.[192] At its core, this basic manifestation of encapsulated trust on the interpersonal level primarily relies on subjective perceptions. In order for me to trust another, what truly matters is my subjective understanding of my own interests and expectations.[193] Of course, these subjective perceptions are minimally tempered by the notion of competence, an objective constraint that addresses not only the factual and cognitive sufficiency of my own beliefs but also the proficiency of others to act as my agent. Still, despite the slight "quality control" function which competence attempts to provide, encapsulated trust in interpersonal relationships remains largely subjective.[194] Absent some fundamental flaw in the formulation of my expectations or the capabilities of those in whom I trust, encapsulated trust on the interpersonal level exists simply to the extent I expect that others will take into account my interests in determining how to act.[195] Most certainly, the very definition of encapsulated trust imposes a certain framework, a structure that places some constraints on what properly constitutes trust. But even within that special framework, at least on the basic level of interpersonal relationships, encapsulated trust remains largely a product of subjective awareness.

Radiating beyond the confines of simple interpersonal relationships, the structure of encapsulated trust logically extends to institutions. Even Hardin acknowledges that from a theoretical standpoint at least, encapsulated trust seems possible between individuals and institutions. Although raising doubts that more than a few individuals could properly place their trust in institutions within the framework of encapsulated interest, Hardin concedes that "[n]evertheless, the encapsulated-interest conception of trust can be generalized to fit institutions."[196] As Hardin explains, encapsulated trust in an institution makes some sense in at least two situations:

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and accompanying text.

192. *See supra* notes 154–61 and accompanying text.

193. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 8–9.

194. HARDIN, TRUST, *supra* note 131, at 13–15; HARDIN, TRUSTWORTHINESS, *supra* note 131, at 6–8.

195. *See supra* notes 173–88 and accompanying text.

196. Hardin, *Trust in Government*, *supra* note 150, at 16; *see also id.* at 13 ("[I]t is clear that in principle—that is to say, conceptually—individuals can trust government, or at least parts of it or some of its agents, even under the relatively demanding notion of trust as encapsulated interest.").

> How, then, can we make sense of trusting an institution if trust requires grounding in the interests of the institution and its agents? There are at least two ways we might unpack our trust of an institution. First, we could trust every individual in the organization, each in the relevant ways, to do what each must do if the organization is to fulfill our trust. Second, we could know that the design of the roles and their related incentives will induce role-holders to do what they must do if the organization is to fulfill our trust. Here we essentially trust the structure of incentives to get individual officeholders to act well as our agents. In this case, the individual role-holders might be broadly interchangeable, and we need know few, if any, of them.[197]

To the extent we possess sufficient information regarding the individual actors representing the institution, trust in an institution is really no different than the basic form of encapsulated trust in interpersonal relationships. We simply reconfigure our sense of the institution as a whole to its component individual parts. Absent that particularized knowledge of the actors within an institution, we can still place our trust in an institution to the extent we possess an adequate understanding of the institutional design that produces incentives for individuals to act on our behalf.[198] As long as we understand sufficiently the incentives that motivate individual actors within the institution, we may sensibly place our trust in the institution itself.

But what Hardin accepts in theory he rejects in practice. With respect to knowing the individual actors within an institution, Hardin seriously doubts that anyone could know enough of the institutional role-holders to form intelligent expectations regarding their motivations.[199] And with respect to basing encapsulated trust on knowledge of institutional design, Hardin states that

> [F]ew people can have an articulate understanding of the structures of various agencies and the roles within them or of the overall government to be confident of the incentives that role-holders have to be trustworthy. Hence, as a matter of actual practice, it is utterly

197. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 29; *see also* HARDIN, TRUST, *supra* note 131, at 151–73, 191–93; Hardin, *Trust in Government*, *supra* note 150, at 22.

198. HARDIN, TRUSTWORTHINESS, *supra* note 131, at 20–23; Hardin, *Trust in Government*, *supra* note 150, at 22.

199. Hardin, *Trust in Government*, *supra* note 150, at 22.

> implausible that trust underlies most citizens' views and expectations of government.[200]

For Hardin, then, institutional trust simply remains out of reach for most people given the information requirements that encapsulated trust necessarily entails.

While Hardin provides solid reasons for dismissing the feasibility of encapsulated trust in enormous and interconnected bureaucratic agencies, his analysis does not seem particularly trenchant with respect to more parochial institutions. In local settings where institutions may be tidy and small, many members of the community might sensibly trust in institutions within the demanding framework of encapsulated interest. Take as an example the town council of a small suburban community lying on the outskirts of some larger metropolitan area. Even in a community of several thousand residents, it does not seem terribly outlandish for many members of the community to know each and every member of the five-person committee in charge of local administrative matters. Moreover, where the entire local police department consists of a police chief, four uniformed officers and two secretaries, it does not seem implausible for many in the community to understand in sufficient detail the web of structural incentives motivating the institutional actors. At least to the extent institutions remain sufficiently small, then, we may sensibly trust in institutions in the very way that Hardin believes would be "utterly implausible".[201]

To be fair, however, Hardin made clear that his discussion of encapsulated trust in institutions focused on government broadly conceived.[202] And the goal here is not to quibble with the level of institutional complexity at which encapsulated trust becomes unintelligible. Instead, the import of the example is to preserve the viability of encapsulated trust—both conceptually and in practice—beyond the confines of simple interpersonal relationships. Why? Because as encapsulated trust extends outward from interpersonal relationships, the nature of encapsulated trust changes somewhat. In interpersonal relationships, encapsulated trust remains highly subjective. While the notion of competence places some constraints on what sensibly counts as trust, those constraints seem rather minimal in the interpersonal setting. In

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200. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 30; *see also* Hardin, *Trust in Government*, *supra* note 150, at 23.

201. Hardin, *Trust in Government*, *supra* note 150, at 22.

202. HARDIN, TRUST, *supra* note 131, at 151–52; Hardin, *Trust in Government*, *supra* note 150, at 19–22.

contrast, objective constraints play a much more crucial and substantive role in the context of institutional encapsulated trust.[203] Simply put, the informational and cognitive hurdles are much more difficult to surmount. Either we need to know each of the actors within an institution or we need to understand the detailed scheme of incentives that motivates each of the institutional actors who remain unfamiliar to us. Thus, where the objective criterion of competence plays only an ancillary role for manifesting encapsulated trust in interpersonal relationships, competence occupies center stage for institutional trust. Without a high level of factual and cognitive sophistication, we simply cannot properly trust in institutions according to the encapsulated interest account. As encapsulated trust moves beyond the confines of interpersonal relationships to institutions, then, the objective constraints become more stringent with respect to what trust necessarily entails.

2. *Encapsulated Trust in Corporate Contexts*

With that understanding of how different contexts change somewhat the basic mechanics of encapsulated trust, the conceptual leap to trust in the context of disclosure obligations becomes more accessible. In light of the definitional requirements of encapsulated trust, however, several pressing questions still spring to mind. In whom or what do I place my trust? How can a corporation effectively take into account my interests? What level of competence is required to sustain a sense of encapsulated trust in that context? The answers to those questions, though closely intertwined, provide a firm foundation for understanding how encapsulated trust presents a useful mechanism for understanding corporate disclosure duties.

So, beginning with the first question, in whom or what do I really place my trust? Trust remains firmly bound to the expectations and observations of particular individuals within institutions. On the interpersonal level, encapsulated trust can only exist to the extent I reasonably expect that another will take my interests into account in determining how to act.[204] With respect to trust in institutions, trust depends on my personal understanding of the incentive structures of the institution or on my knowledge of all the actors within the institution.[205] Regardless of the

203. Hardin, *Do We Want Trust in Government?*, *supra* note 151, at 38–40; Hardin, *Trust in Government*, *supra* note 150, at 23–24.

204. *See supra* notes 190–94 and accompanying text.

205. *See supra* notes 195–202 and accompanying text.

shape encapsulated interest takes, on a fundamental level, encapsulated trust cannot be expressed without reference to the particular circumstances of the trusting and the trusted.

In the case of corporate communications, even though the human author of any particular disclosure may remain hidden, the well established hierarchical structure of the corporate form makes the officers and directors of the corporation the obvious locus of our trust. Indeed, under state corporate and federal securities laws, officers and directors remain ultimately liable for fraudulent statements of the corporation.[206] It is the very rigidity of the corporate form itself and the legal imposition of fiduciary duties on directors and officers that makes those particular actors the reciprocal participants in a trusting relationship with consumers and investors.

Our expectations that corporate actors are grounded in the interests of investors and consumers should not exclusively control whether or not encapsulated trust remains intelligible. Even if we ignore what motivates another to follow a particular course of action, we can still manifest encapsulated trust in communication to the extent the governmental authority considers our interests in determining what adherence to the disclosure duty permits or prohibits in a particular context.[207] So rather than merely resting on my expectations of what motivates another to act, my sense of encapsulated trust should also address whether or not I reasonably believe the governmental decision to allow the action of another was grounded in my interests in the right at stake.[208] Most certainly, that governmental decision may require untangling the motivations of others whose actions give rise to a breach of fiduciary duty

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206. *See* Siebecker, *supra* note 9, at 651–55; *see also* THOMAS LEE HAZEN, PRINCIPLES OF SECURITIES REGULATION 13–15 (2005); Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 941–42 (2003) (stating that new anti-fraud provisions under Sarbanes-Oxley "were already in effect due to requirements imposed by stock exchanges, regulators, state law, or other provisions of federal law. Others were widely accepted and followed as best practices"); David A. Skeel, Jr., *Icarus and American Corporate Regulation*, 61 BUS. LAW. 155, 155–68 (2005) (describing the two-tier system of state and federal corporate fraud regulation).

207. Hardin certainly doubts that individuals might possess the requisite knowledge and familiarity with government to trust in any meaningful sense. *See* HARDIN, TRUST, *supra* note 131, at 39–40. Still, that criticism focuses on the inability of individuals to know the incentives of the actors within the institutional setting. If the governmental standards for assessing and enforcing corporate disclosure obligations made direct references to encapsulated trust, it would seem entirely plausible for individuals to manifest a meaningful sense of trust in the governmental application of that particular standard.

208. For a discussion on the role that legal sanction plays in sustaining trust, *see* HARDIN, TRUSTWORTHINESS, *supra* note 131, at 127–28.

claim. The viability of encapsulated trust in corporate disclosures will often depend on the grounds articulated for permitting or prohibiting the actions of others.

But how do corporate actors effectively take into account my interests? At least from a theoretical standpoint, the requirement that we must reasonably expect our interests to be taken into account does not pose a terribly difficult problem. To the extent the actions of individuals, institutions, or governmental authorities are motivated by our interests through a particular legal obligation, our sense of encapsulated trust may thrive.[209] Still, it seems rather difficult to believe that a corporation took my interests into account in deciding not to disclose information I specifically demanded—in fact, this would seem wholly at odds with my interests. The answer lies in our ability to articulate some underlying justification that supports the actions of the corporation in a particular context. So, even if I think that the corporation acted in a way that undermined my immediate self-interest, I might still trust that the corporation acted in my interests if it were possible to locate some greater good that is maintained through permitting those seemingly harmful or unsatisfying acts of another. Locating the underlying justifications that support a sense of encapsulated trust as governing a fiduciary duty of disclosure, however, presents a rather difficult task. The process involves a certain degree of detachment from our own immediate self-interest and an attentiveness to the interests of other stakeholders.

So what level of competence does encapsulated trust require in the corporate communication context? Remember that competence addresses the factual and cognitive sufficiency of the expectations that support encapsulated trust.[210] In the case of interpersonal relationships, competence plays only a minor "quality control" function that attempts to secure some sense of reasonableness slightly above the mark set by mere rationality.[211] With respect to encapsulated trust in institutions, the criterion of competence has much more bite. Because encapsulated trust in institutions requires knowing each of the individual actors within an institution or understanding in sufficient detail the internal scheme of incentives the institution provides, encapsulated trust cannot sensibly

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209. The ability to trust based on the availability of legal sanction seems wholly compatible with the architecture of encapsulated trust, at least to the extent those sanctions directly address the very existence—and enforceability—of encapsulated trust as a fiduciary duty. *But see* HARDIN, TRUSTWORTHINESS, *supra* note 131, at 47–48.

210. *See supra* notes 175–87 and accompanying text.

211. *See supra* notes 192–94 and accompanying text.

occur without a broad factual foundation or a well-developed capacity to understand the workings of the institution itself.[212] As long as consumers and investors remain confident that the scope of the fiduciary duties owed by officers and directors remains precisely consonant with what encapsulated trust requires, investors and consumers can sensibly trust those institutional corporate actors.

So with that basic understanding, how would courts apply encapsulated trust in the context of a fiduciary duty of disclosure? Arguably, if challenged, directors and officers would need to demonstrate that in making a particular disclosure, they competently took into account the interests of shareholders regarding the substance and form of the disclosure. Turning to the Monster.com example used at the outset, if a disgruntled shareholder argued that Monster.com officers and directors violated their duty of care by failing to disclose effectively material information, company actors would simply need to demonstrate the decision to "quietly post[] an online notice"[213] about a data security breach took into account shareholder interests following an ongoing dialogue about the content, form, and timing of disclosures on such matters. In essence, the duty is a *process-based standard* that relies on enhanced discourse to improve the integrity of decisions on corporate disclosures. Although perhaps rather modest in scope, that emphasis on improved discourse between the corporations and their constituencies should provide substantial improvements over the current disclosure regime.

It seems that the encapsulated interest account of trust could fit within the existing legal framework of fiduciary duties owed by officers and directors to the corporations and shareholders they serve. And it is precisely because that fiduciary duty framework is extant that an encapsulated interest account of trust seems viable. While the ability to trust in institutions might arise infrequently, the duty of trust that already exists at the core of corporate law makes the encapsulated account of trust a rather easy fit.

IV. REPERCUSSIONS OF ENCAPSULATED TRUST

So what are the implications of embracing encapsulated trust as governing the content of the officers' and directors' fiduciary duties regarding corporate disclosures? Adopting such a philosophically robust foundation for a duty of disclosure produces some significant benefits

212. *See supra* notes 195–202 and accompanying text.
213. *See supra* note 1 and accompanying text.

including enhanced efficiency, greater stakeholder engagement, and improved business and legal ethics.

A. Efficiency

Perhaps the most interesting implication from a theoretical standpoint is the promotion of an efficient level of corporate communication.[214] At the outset, claiming that an encapsulated account of trust promotes efficiency may seem particularly odd, considering the trust remains an intensely normative construct.[215] Nonetheless, at least compared to current standards for disclosure, fiduciary duties governed under an encapsulated interest enhance the likelihood of a Pareto efficient outcome regarding the content of disclosure duties.

In order for directors and officers to fulfill a duty of encapsulated trust regarding corporate disclosures, they need to take into account the interests of the corporation's shareholders.[216] According to the encapsulated interest account, however, it is not enough simply to imagine the interests of a particular shareholder, such as a rational, self-interested stockholder bent on maximizing short-term gain.[217] Instead, the encapsulated interest account requires taking seriously and encapsulating the actual interests of those who have given their trust.[218] To the extent some shareholders possess preferences for long-term gain, fair labor practices, living wages, environmental sustainability or charitable giving, the views of those shareholders must be taken as they exist. Contrary to

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214. "Pareto Efficiency" represents a particular concept of efficiency articulated by Vilfredo Pareto. *See generally* VILFREDO PARETO, MANUAL OF POLITICAL ECONOMY (1971). According to Pareto, an efficient allocation of resources exists when no person could be made better off without making another individual worse off. *Id.* Although other notions of efficiency exist, this Article employs the traditional economic understanding of Pareto efficiency. For a discussion of competing theories of efficiency, see Michael I. Swygert & Katherine Earle Yanes, *A Unified Theory of Justice: The Integration of Fairness Into Efficiency*, 73 WASH. L. REV. 249, 267 n.80 (1998).

215. *See* Barbara Fried, *Is As Ought: The Case of Contracts*, 92 VA. L. REV. 1375, 1386–89 (discussing the incompatibility between efficiency and normative theory); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697 (1996) (addressing the likely inefficiency of norms in regulating behavior); Jedediah Purdy, *A Freedom-Promoting Approach to Property: A Renewed Tradition for New Debates*, 72 U. CHI. L. REV. 1237, 1241 n.13 (2005) (identifying tensions between the narrative efficiency and normative property rights theories).

216. Encapsulated trust would require taking into account the interests of other stakeholders, such as employees, community members, or suppliers, to the extent that shareholders care about those constituencies. Thus, although not requiring in the first instance consideration of stakeholder views, encapsulated trust requires taking into account interests of shareholders whose views may themselves extend to stakeholder concerns.

217. HARDIN, TRUST, *supra* note 131, at 58–60; HARDIN, TRUSTWORTHINESS, *supra* note 131, at 16–18.

218. COOK ET AL., COOPERATION WITHOUT TRUST?, *supra* note 132, at 5–6.

much traditional law and economics scholarship that receives fast criticism for adopting a highly stylized and stilted view of the human condition as the basis for defining the content of the law,[219] an encapsulated interest account adopts a much more behavioral economics approach.[220] But that behavioral sensitivity necessarily marks a Pareto improvement. Simply divining the law based on assumptions of what rationality entails cannot come nearly as close as a behaviorally sensitive approach to approximating the bargain actual parties would strike regarding the desired content disclosure duties.[221]

A fiduciary duty based on encapsulated trust promotes efficiency, then, because it forces attention on the full panoply of actual actors and their expressed interests. While cognitive dissonance problems affecting accurate articulation and assessment of interests may still persist,[222]

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219. *See, e.g.*, Williams, *supra* note 46, at 1657:

> Important trends in legal education and legal theory, however, complicate the goal of producing lawyers who will take a Hartian perspective and who will understand companies' need for social legitimacy. Chief among those trends, in my view, is the teaching of "primitive" law and economics, which has taken the neoclassical economist's stylized picture of the person, *homo economicus*, a self-interested utility maximizer, and has assumed that this two-dimensional person occupies the real world, subjecting every aspect of life to a cost-benefit analysis, including decisions about law compliance.

Id.

220. For a description of the distinction between a classical economic approach to understanding human behavior and a behavioral economic sensitivity, see Robert A. Prentice, *Chicago Man, K-T Man, and the Future of Behavioral Law and Economics*, 56 VAND. L. REV. 1663, 1667 (2003):

> The essential inaccuracy of the rational man model has minimized the capacity of law and economics to generate useful insights in many areas of the law. Dissatisfaction with this state of affairs gave rise to a movement, variously called Behavioral Law and Economics (BLE), Behavioral Decision Theory (BDT), and Legal Decision Theory (LDT), that seeks to provide a more descriptively and predictively accurate account of human behavior; this is done by replacing the law and economics movement's stylized rational man model with a more accurate model based on empirical research arising from psychology, cognitive science, behavioral biology, decision theory, and related fields.

Id.

221. *Id.*; *see also* Douglas A. Kysar, *Sustainability, Distribution, and the Macroeconomic Analysis of Law*, 43 B.C. L. REV. 1, 4–5 (2001):

> In recent years, however, a group of scholars has devoted considerable insight and energy to the project of behavioral law and economics. This emerging subdiscipline fuses traditional neoclassical economic analysis with lessons drawn from cognitive psychology and decision theory research. The result is a law and economics grounded in assumptions that comport better with observed real-world behavior than the stylized rational actor model featured in conventional law and economics. The fruits of this effort are now dominating new research in law journals, such that it is no overstatement to conclude, "The future of economic analysis of law lies in new and better understandings of decision and choice."

Kysar, *supra* note 221, at 4–5 (citations omitted); *see also* Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 583–89 (2002).

222. *See* Paredes, *supra* note 59, at 443–44.

refocusing the content of fiduciary duties through the lens of encapsulated trust prevents ignoring players who should enjoy a seat at the bargaining table.

Moreover, the sense of competence necessary to assess accurately shareholder (or stakeholder) interests will require a more substantial dialogue between the corporation and its shareholders. Because encapsulated trust requires actual knowledge of the interests being encapsulated,[223] corporations arguably could not fulfill that duty without reaching out to shareholders. Some of those shareholders may fit the classical economic profile of self-interested rational beings dedicated to maximizing short-term wealth.[224] But if other shareholders interested in social responsibility exist, corporations must engage to assess their interests effectively.[225] That engagement would have to cover not just the underlying content of CSR concerns but also the kind of disclosures necessary to assess corporate practices in those areas. In essence, embracing an encapsulated-interest-based fiduciary duty would bring *real* shareholders and *real* shareholder interests into the corporate decision-making process, without giving shareholders any direct control over the course the business takes.

Most certainly, disclosure duties founded on encapsulated trust would not cure all of the systemic information failures threatening the viability of CSR. A more philosophically robust sense of encapsulated trust simply cannot ensure with any certainty that corporations will disclose only perfectly tailored, wholly truthful information that permits the most effective assessment of CSR practices. But there should be some improvement, especially with respect to the ability to engage in brazen greenwash or obfuscation without fear of detection. Fiduciary duties based

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223. *See supra* notes 151–61 and accompanying text.

224. *See supra* Part II.A.

225. *See supra* notes 215–16 and accompanying text. For a discussion on the need to assess the actual preferences and profiles of diverse stakeholders in corporate law, see Helen Anderson, *Creditors' Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness*, 30 MELB. U.L. REV. 1, 24:

> [T]he long-term viability of the corporate enterprise relies on the cooperation of a range of corporate stakeholders. In order to achieve this cooperation, ethics and fairness must be considered as a means of fostering trust and reducing risk and its associated costs. While directors are allowed to favour one cohort of corporate stakeholders over another, this is only permissible where this is in the long-term interests of the company.

Id.; *see also* Greenfield, *supra* note 221, at 622, 635–37, 642–43 (addressing the need to take seriously all extant stakeholder interests in order to promote efficiency from a behaviorally sensitive standpoint); Cynthia Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705 (2002) (promoting a dedication to actual stakeholder and shareholder interests in corporate decision making).

on an encapsulated account of trust would likely impose a more stringent duty of care on officers and directors, at least with respect to the *process* of attending to those duties.[226] That heightened procedural standard—one that requires taking seriously the actual interests of extant shareholders and other corporate constituencies—might be enough to escape the confines of the Prisoner's Dilemma and the reverse Tragedy of the Commons that seem to plague the CSR movement.[227] Quite simply, the less likely corporations could deceive without detection and the less likely companies could obfuscate through dissemination of vast amounts of irrelevant data, the more likely consumers and investors will continue to reward companies that embrace CSR. The heightened standard of an encapsulated interest account of trust effectively moves the equilibrium position to a cooperative outcome where the parties—consumers, investors, and the corporation—realize shared gains.[228] In that important way, a normatively robust account of trust as a basis for fiduciary disclosure duties prevents significant economic waste.[229]

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226. The precise contours of the duty of care remain open under an encapsulated account. The existence of some latent ambiguity, however, does not necessarily detract from the benefits of embracing encapsulated trust. It is the change in the process of approaching corporate disclosure, rather than a change in the substance of the duties, that marks the primary improvement over the existing regulatory regime. So while grounding a fiduciary duty of disclosure on a philosophically robust sense of trust may likely enhance disclosure obligations, that substantive change emerges as an inevitable repercussion of a more substantial and meaningful procedural change in corporate discourse. Whether or not that discourse actually produces more or less disclosure simply does not affect the benefit of tethering more closely corporate disclosure practices to the interests of shareholders and other corporate constituencies. And it is precisely that enhanced connection between corporate practices and constituency interests in the context of disclosure that could help remove the existing threat to the economic viability of CSR and SRI.

227. *See supra* notes 77–79 and accompanying text.

228. *See* Christopher R. Leslie, *Antitrust Amnesty, Game Theory, and Cartel Stability*, 31 J. CORP. L. 453, 462–63 (2006):

> Experimental evidence supports the proposition that trust is a solution to the prisoner's dilemma. Results from prisoner's dilemma tournaments, in which each player employs its particular strategy against each other player seriatim, show that distrusting strategies fail in the long run and more trusting strategies prevail. When players utilizing trusting strategies are paired up, they solve the prisoner's dilemma in experiments and achieve greater gains than those using distrusting strategies.

Id.; *see also* Russell Hardin, *Distrust*, 81 B.U. L. REV. 495, 498–501 (2001) (describing how trust secures a mutually beneficial equilibrium solution for players in the Prisoner's Dilemma, while distrust results in mutual defection); Christopher R. Leslie, *Cartels, Agency Costs, and Finding Virtue in Faithless Agents*, 49 WM. & MARY L. REV. 1621, 1692 (2008) (stating in the context of cartel pricing that "[t]he solution to the prisoner's dilemma is mutual trust").

229. *See* Leslie, *Antitrust Amnesty*, *supra* note 228, at 462–65; Richard H. McAdams, *Relative Preferences*, 102 YALE L.J. 1, 20–27 (1992) (describing how the prisoner's dilemma leads to economic and social waste).

Some might charge, however, that the inherent flexibility in the common law duties would produce a lack of clarity and predictability.[230] While the malleable nature of the common law principles might produce some advantages, the inherent uncertainty in the method could produce significant transaction costs that impede achieving an efficient level of corporate disclosure.[231] Unless the law articulates a set of sufficiently concrete standards, corporations could be left foundering without sufficient ability to organize their conduct. Moreover, with a more stringent duty of disclosure, increased litigation would result as shareholders attempt to push corporations for more, or simply different, information.[232] Even good faith efforts by corporations to comply with their fiduciary disclosure duties might not allow them to escape the enhanced costs of litigation, as courts develop the content of the disclosure duty on a case-by-case basis.[233]

While compelling at first blush, those arguments fail to attend to the evolving development of a kind of "best practices"[234] regarding corporate

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230. *See* Richard J. Agnich & Steven F. Goldstone, *What Business Will Look for in Corporate Law in the Twenty-First Century*, 25 DEL. J. CORP. L. 6, 9 (2000) (arguing that a fundamental tension exists between "the flexibility that we all cherish so much in the law and the common law versus a businessperson's need for clarity and predictability"); William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance Contracts*, 33 TORT & INS. L.J. 1, 34 (1997) (stating in the context of reinsurance contracts that "[c]ommentators unvaryingly criticize the persistence of the old common law tests and call for their reform, pointing to a need for uniformity, clarity, and flexibility in the law") (citations omitted); *see also* Siebecker, *Cookies*, *supra* note 127, at 944–45.

231. *See, e.g.*, Baird & Henderson, *supra* note 101, at 1333:

> Ridding corporate law entirely of the idea of fiduciary duties would force the reconceptualization of a number of features of the law in ways that are potentially healthy. We consider one of these here—disclosure. Under current law, directors' disclosure obligations are tied inexorably to their fiduciary duties. . . . A more sensible approach is one that decouples the disclosure obligations from other duties and also makes it easier for sophisticated professionals both to opt out of disclosure obligations and opt into them. Fiduciary duties restrict free contracting in ways that are plainly inefficient.

Id.

232. *See* Frank Easterbrook & Daniel Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW 300–02 (1991); Kellye Y. Testy, *Linking Progressive Corporate Law With Progressive Social Movements*, 76 TUL. L. REV. 1227, 1235–38 (2002) (discussing some of the costs associated with more stringent standards of disclosure for CSR practices and enhanced stakeholder rights).

233. Despite the concern over increased costs, the very availability of litigation may actually promote an efficient disclosure rule. *See* George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 72 (1977) ("The tendency toward efficiency is a function of the common law process according to which legal rules are generated from the investment in litigation by individual parties . . . .").

234. For a definition of the concept of "best practices," see David Zaring, *Best Practices*, 81 N.Y.U. L. REV. 294, 297–98 (2006):

> At their core, best practices are a method of regulation that works through horizontal modeling rather than hierarchical direction. In a classic best practices scheme, regulated entities themselves devise practices to comply with relatively unspecific regulatory

disclosure duties. Most certainly, a lack of predictability regarding the content of disclosure duties and increased litigation would produce significant costs. Those costs, however, do not necessarily impede moving toward an efficient level of corporate communication. Instead, those costs actually facilitate a Pareto improvement by encouraging corporations to pay continual attention to the evolving preferences for disclosure of corporate information.

In contrast, although adhering to static disclosure standards would promote predictability, the very immovability of those standards could not accommodate changing market preferences regarding the desired content of corporate communication.[235] Efficient corporate communication represents the level of disclosure that corporate managers, shareholders, consumers, and other stakeholders would hypothetically negotiate in a world of perfect information and without the burdens of any transaction costs in bargaining.[236] The precise outcome of that hypothetical negotiation would necessarily change as the preferences of any party evolve. A rigid set of disclosure standards, however, could not attend to changing preferences. To the extent preferences regarding corporate disclosure levels change over time, steadfast reliance on static disclosure standards would undermine efficiency despite providing predictability.[237]

Thus, determining whether a malleable fiduciary duty approach or a much more static statutory framework enhances the likelihood of an efficient level of disclosure depends on an assessment of the nature of

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> requirements. . . . Defined this way, best practices might seem like a benign form of localism or subsidiarity, a method of regulation in which central administrators provide advice and disseminate information, instead of mandating a one-size-fits-all regulatory scheme. Indeed, it might suggest a rather democratic form of regulatory experimentalism, in which regulated entities experiment with best practices as a way of vindicating the broad principles of various regulatory programs, while the regulators keep track of their progress and help to celebrate and publicize particularly successful local initiatives.

Id.

235. *See* Hamermesh, *supra* note 121, at 1153 ("[A] fiduciary duty of disclosure provides a convenient, ready-made substitute for what selling stockholders would want in any event—presentation of the material facts—and what directors, by virtue of their role as centralized repositories of corporate information, are well suited to provide efficiently."); *see also* Funk v. United States, 290 U.S. 371, 383 (1933) ("It has been said so often as to have become axiomatic that the common law is not immutable but flexible, and by its own principles adapts itself to varying conditions."); Paul Rubin, *Why Is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977) (arguing that common law standards promote dispute resolution and decrease litigation costs).

236. *See* Hamermesh, *supra* note 121, at 1152–54; Williams, *supra* note 29, at 1201–03.

237. *See* Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 FORDHAM L. REV. 1785, 1829 (1998) ("Even when harmonized standards are formed, it will take a long time until they are implemented. By then, economic conditions might have changed, causing the unified standards to become outdated and making renegotiation necessary. Indeed, a static structure would surely render the harmonized standards inefficient.").

market preferences. If those preferences remain static, enduring the costs of a malleable approach would seem wholly unnecessary. On the other hand, if market preferences regarding the substance and character of corporate communication evolve, only a malleable common law approach could attend adequately to those changing preferences. The explosive growth of CSR and SRI seems to indicate rather clearly that disclosure preferences remain subject to change.[238] To the extent the $2.7 trillion dedicated to SRI in the United States generates significant wealth, the costs of enduring static disclosure standards become all too clear—it produces the tragedy of transparency that threatens the basic viability of CSR going forward. So, even if increased litigation and a lack of predictability accompany a malleable fiduciary duty of disclosure, those costs actually facilitate a Pareto improvement over continued adherence to static disclosure duties.

In the end, a fiduciary duty of disclosure promotes "best practices" to develop regarding corporate communication.[239] With a malleable fiduciary duty of disclosure based on encapsulated trust, corporations will continually be obligated to reflect on the quantitative and qualitative sufficiency of their public disclosures.[240] Rather than providing a one-size-fits-all disclosure standard for every corporation, a fiduciary disclosure duty based on encapsulated trust requires a rather disciplined organizational introspection. What marks sufficient disclosure for any corporation will depend on the dialogue between the corporation and its constituencies regarding the substance of corporate disclosures as well as the manner of those disclosures.[241] The point is not that corporations must heed every stakeholder preference regarding information disclosure. Rather, by instantiating encapsulated trust in a disclosure duty, corporations will continually refine as a matter of course their own understanding of what marks appropriate disclosure practices. To be sure, the threat of litigation from disgruntled shareholders provides the incentive to engage in the reflective process. But as that practice takes hold and shareholders become a regular part of the dialogue regarding corporate

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238. *See supra* notes 227–30 and accompanying text.

239. *See supra* note 231 and accompanying text. *But see In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 697 (Del. Ch. 2005) (asserting that it would be inappropriate to apply modern notions of corporate "best practices" to disclosure obligations).

240. *See* Hamermesh, *supra* note 121, at 1152–54.

241. *See* Z. Jill Barclift, *Codes of Ethics and State Fiduciary Duties: Where Is the Line?*, 1 J. BUS. ENTREPRENEURSHIP & L. 237, 239 n.9 (2008) (describing under various "best practices" disclosure initiatives, the need for interaction and discourse among a wide range of corporate actors and stakeholders).

disclosure practices, the instances of litigation should wane. For by engaging and taking seriously the discourse, the corporations fulfill their duty based on encapsulated trust and thereby insulate themselves from shareholder attack.

B. Engagement

A fiduciary duty of disclosure based on encapsulated trust promotes much greater engagement by corporate constituencies. As already discussed in the context of efficiency, attaining the competence necessary to understand adequately the interests of shareholders requires corporations to engage in robust discourse with shareholders.[242] But how could corporations actually approach that discourse? What mechanisms would enable corporations to fulfill their fiduciary duty?

A duty to take seriously the concerns of shareholders would likely accelerate the development of intermediating organizations[243] that already play an important role in the CSR movement. Although corporations could attempt to survey the viewpoints of every shareholder, gaining the requisite sense of competence regarding shareholder interests seems possible through much less extraordinary means. In particular, corporations could engage in regular consultation with shareholder or other constituency groups. Already, a large number of non-governmental organizations exists that represent shareholder concerns, whether regarding environmental sustainability, organic production, fair labor standards, non-discrimination policies, or a host of other matters.[244] In an effort to gain competence regarding the views that shareholders actually possess, corporations might look to these organizations as surrogates for articulating shareholder preferences.[245]

The involvement of shareholder advocacy groups in corporate decision making could raise concerns for business managers and investors.[246] Part

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242. *See supra* Part IV.A.

243. *See* Jayne W. Barnard, *Corporate Boards and the New Environmentalism*, 31 WM. & MARY ENVTL. L. & POL'Y REV. 291, 305–06 (2007) (addressing the growth of various interest groups that represent stakeholder claims to corporate managers).

244. *See* R. Timothy S. Breen et al., *The Chief Strategy Officer*, HARV. BUS. REV., Oct. 1, 2007, at 84; Siebecker, *supra* note 9, at 616–17.

245. Howard B. Adler, *The Emerging Role of Activist Shareholders and Destabilizers*, 922 PRACTISING L. INST. 131, 141 (1996); Steven A. Rosenblum, *Proxy Reform, Takeovers, and Corporate Control: The Need for a New Orientation*, 17 J. CORP. L. 185, 209–10 (1991) (describing the potential for enhanced communication between shareholders, stakeholder groups, and corporate managers).

246. *See generally* Clive Crook, *The Good Company*, ECONOMIST, Jan. 20, 2005, at 1–6 (discussing potential deleterious effects on business management and public welfare associated with

of the problem focuses on the aggregate effect of nettlesome distractions that shareholder advocates pose for officers and directors.[247] Another important concern targets the basic judgment of groups that promote particular issue preferences that may be at odds with the overall good of the corporation or with the values of competing shareholder groups.[248] Related to that concern is a question of whether groups voicing opinions actually represent shareholder opinions. To the extent those advocacy groups present peculiar viewpoints not possessed by shareholders, the interests encapsulated by the corporation are not authentic. As a result, the level of disclosure adopted would stray from an efficient level.

Even if excessive shareholder involvement in business management might produce deleterious effects for the corporation, however, attending to the views of shareholder or other constituency groups regarding disclosure issues seems much less problematic. After all, what remains at stake is simply the quantity and quality of corporate disclosures. The discourse between the corporation and its constituencies need not engage the substantive merits of the advocacy groups' interests or heed particular calls for changing corporate practices outside the disclosure context. Instead, what simply matters is taking into account the interests expressed regarding the disclosure of corporate information.[249] While disclosure of information might fuel constituency groups, providing desired data could also quell shareholder foment.[250] In any event, at least with respect to understanding shareholder interests regarding what constitutes adequate disclosure, the enhanced role of shareholder or constituency advocacy groups seems rather benign.

Beyond those bodies that directly advocate certain shareholder or stakeholder interests, organizations that develop standards for disclosure would seem to provide an increasingly important source for understanding shareholder interests regarding disclosure itself. Currently, a variety of governmental, non-governmental, and for-profit organizations attempt to craft standards for corporate communication. For example, the United Nations, though its Global Compact,[251] and groups like the Global

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compliance with stakeholder demands for CSR).

247. *See, e.g.*, Chuck Jaffe, *When Making Money Takes a Back Seat to Advocacy*, CHI. TRIB., Jan. 26, 2006.

248. *See* Clive Cook, *The World According to CSR: Good Corporate Citizens Believe that Capitalism Is Wicked but Redeemable*, ECONOMIST, Jan. 20, 2006, at 6, 8.

249. *See supra* notes 215–16 and accompanying text.

250. *See* POHLE & HITTNER, *supra* note 26, at 8.

251. The Global Compact articulates a uniform set of social and environmental principles to foster responsible corporate citizenship. *See* United Nations Procurement Division, The Global Compact,

Reporting Initiative[252] promulgate standards for disclosure that corporations voluntarily embrace.

Emphasizing the role of these standard-making entities may seem to undermine the flexibility of a common law fiduciary duty of disclosure. Were those organizations to provide some legal sanction for the level of disclosure announced, their efforts might undercut some significant benefits associated with a fiduciary duty of disclosure based on encapsulated trust. But as hortatory entities that simply encourage similar disclosure methods and accounting principles, what seems to develop is a global market for disclosure standards.[253] That market could provide a springboard or an initial framework for understanding the parochial disclosure preferences of shareholders in any particular corporate setting.

In a fundamental sense, embracing a fiduciary duty of disclosure based on encapsulated interest fosters robust engagement by corporate constituencies. Although excessive shareholder involvement in business management might negatively affect corporate effectiveness, in the realm of gathering information about disclosure preferences, the dialogue seems essential to producing an efficient level of corporate communication.

C. Ethics

Beyond efficiency and engagement, encapsulated trust stimulates ethical business and legal practices. By mandating more thoughtful consideration of constituency interests, encapsulated trust encourages a discourse that situates corporations within communal contexts. Fostering the notion of the corporation as contextually situated rather than isolated will inevitably spark a greater sensitivity to the purposes and repercussions of corporate practices, from both internal and external vantage points.[254]

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http://www.un.org/Depts/ptd/global.htm (last visited Sept. 3, 2008).

252. According to the Global Reporting Initiative (GRI) Web site, the GRI "is a large multi-stakeholder network of thousands of experts, in dozens of countries worldwide, who participate in GRI's working groups and governance bodies, use the GRI Guidelines to report, access information in GRI-based reports, or contribute to develop the Reporting Framework in other ways—both formally and informally." *See* Global Reporting Initiative, Who we are, http://www.globalreporting.org/AboutGRI/WhoWeAre/ (last visited Sept. 3, 2008).

253. *See* Pitts, *supra* note 26, at 483 ("This decade has witnessed proliferating company and industry codes of conduct, global and sector-specific multistakeholder initiatives, monitoring standards and organizations, labeling and certification schemes, NGO-based guidelines, reporting standards, and legislative, judicial, and administrative law developments on an almost daily basis.").

254. *See* Goran Svensson & Greg Wood, *Proactive Versus Reactive Business Ethics Performance: A Conceptual Framework of Profile Analysis and Case Illustrations*, 4 CORP. GOV. 18, 23 (2004):

> [T]he conceptual discussion of business ethics is linked to a micro level in the society. This means that the internal perception is a point of reference for the forthcoming discussion of

That change reflects an improved ethical outlook, for it marks an enhanced mindfulness of the organization itself.[255] Self awareness, rather than willful blindness, represents an essential component of ethical conduct.[256]

Moreover, embracing encapsulated trust as the animating principle of disclosure obligations will inevitably cause individuals within the corporate structure to become more ethically self aware.[257] The principles guiding an institution affect significantly perceptions of institutional identity.[258] And this does not just affect the directors and officers who directly bear the fiduciary duties—to the extent the language of trust becomes a part of daily discourse within the organization's structure, individuals throughout the organization will embrace more readily that concept as a constitutive part of their roles in the corporation.[259] With a heightened awareness of the importance of trust to the basic obligations of the corporation, corporate actors will embed that sensibility in their approach to doing business.

The means by which that language of trust gets introduced to the corporation focuses on the enhanced ethical role of lawyers.[260] Both internal general counsels and outside corporate lawyers bear the responsibility of explicating for corporate actors the behaviors and practices that comport with existing legal standards.[261] Absent a

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> business ethics performance in the marketplace. The internal perception may be that of the employer, the employees and/or the owners/shareholders. Another point of reference is the external perception. The external perception may be that of the customers, the suppliers, and/or other publics.

Id.

255. *See* Neil Buck, *Corporate Governance—More than a State of Mind?*, *in* GOVERNING THE CORPORATION 273, 273 (Justin O'Brien ed., 2005) (arguing that "governance needs to be at least a state of mind first among the Board and high officials and before the systems procedures, culture and behaviours necessary to sustain it can follow").

256. *See* Kent Greenfield, *Corporate Ethics in a Devilish System*, 3 J. BUS. & TECH. L. 427, 433–34 (2008).

257. *Id.*; *see* Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory For Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771 (2007) (discussing how embracing a rhetoric of social responsibility can promote ethical outlooks of various corporate actors).

258. Fairfax, *supra* note 257, at 805–10 (discussing how corporate policies and governance practices affect perceptions of corporate identity).

259. *See* Roderick M. Kramer, *Trust and Distrust in Organizations: Emerging Perspectives, Enduring Questions*, 50 ANN. REV. PSYCHOL. 569, 569–71 (1999).

260. *See* Pitts, *supra* note 26, at 484:

> [N]o lawyer interfacing with corporations, or working within one, can afford to be ignorant of CSR's basic content, principles, and processes or the variety of existing soft and hard law instruments that can either cause problems and/or offer solutions when CSR issues and dilemmas arise. . . . [N]eglecting to consider these issues will increasingly amount to failure of professional responsibility and of directors' fiduciary duties.

Id.

261. *See* M. Peter Moser & Stanley Keller, *Sarbanes-Oxley 307: Trusted Counselors or*

philosophically robust encapsulated interest account of trust serving as the basis for a fiduciary duty of disclosure, the ethical obligation of zealous representation[262] enables lawyers to counsel corporate clients on the range of disclosure practices that, with differing levels of risk, arguably comply with legal mandates.[263] The project seems entirely consequentialist and focuses simply on the information disclosed.

Within the framework of a fiduciary duty of disclosure based on encapsulated trust, zealous representation necessarily involves an attention to *process* rather than simply to the consequences of compliance. Why? For at a minimum, zealous representation requires attending to the controlling legal standards. When the standard is encapsulated trust, satisfying that standard requires embracing a method of discourse. Even if lawyers still provide counsel at the base minimum necessary to comport with the law,[264] the role of lawyers within the corporate setting necessarily becomes one of educating corporate actors about the meaning, import, and process of encapsulated trust. Perhaps surprising, it is corporate lawyers, then, who serve as the prime movers in enhancing business ethics.[265] It is the lawyers who instill and monitor the practices that satisfy the dictates of encapsulated trust. Clearly, nothing about the substance of encapsulated trust alters the basic ethical mandate of zealous representation that lawyers owe their clients. But in counseling about what satisfies encapsulated trust, corporate lawyers take on the role of instilling ethical practices in their clients rather than simply identifying the outcome that marks minimum compliance.

Thus, an encapsulated interest account of trust provides a strong basis for a duty of disclosure and fits rather comfortably within the existing fiduciary framework for officer and director duties. Moreover, embracing that philosophically disciplined approach promotes an efficient quantity and quality of corporate disclosures, encourages more robust dialogue

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Informers?, 49 VILL. L. REV. 833, 841–42 (2004) ("When representing a client as an adviser, the lawyer's main function is to provide the client with an informed understanding of the client's legal rights and obligations and to explain their practical implications.").

262. *See* MODEL RULES OF PROF'L CONDUCT (2002).

263. For a detailed discussion of the ethical tensions facing inside counsel in advising corporate clients, see Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 1001–29 (2005).

264. *See* Benjamin H. Barton, *The ABA, the Rules, and Professionalism: The Mechanics of Self-Defeat and a Call for a Return to the Ethical, Moral, and Practical Approach of the Canons*, 83 N.C. L. REV. 411, 434–37 (2005) (discussing the "minimalist" ethical approach to legal counseling).

265. *See, e.g.*, Peter C. Kostant, *Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate Legal Practice*, 84 MINN. L. REV. 1213 (2000) (discussing how adopting a more holistic approach to legal counseling could produce improvements in business ethics and prevent corporate scandals).

between corporations and the constituencies they serve, and produces enhanced ethical business and legal practices.

V. CONCLUSION

Crafting appropriate regulatory structures for the world's financial markets requires a nuanced, interdisciplinary understanding of the nature of corporations, the internal and external factors influencing corporate behavior, and the relationships between corporations, stakeholders, and society in general. Such a comprehensive approach simply attempts to inject realism into regulation. To diminish threats to market integrity, regulatory policies should better attend to the complex web of social, economic, and political factors affecting corporate incentives and function over time.

With respect to the tragedy of transparency threatening the viability of CSR, articulating a fiduciary duty of disclosure based on an encapsulated interest account of trust could help limit abuses of corporate power and promote greater corporate sensitivity to the communities they inhabit. Moreover, by attending more accurately to the interests of shareholders and other stakeholders regarding the quality and quantity of corporate communications, an encapsulated trust based duty of disclosure will promote efficient corporate communication, greater stakeholder engagement, and more ethical legal and business practices. Locating disclosure obligations in such a philosophically disciplined fiduciary duty would not guarantee completely accurate and comprehensive corporate communication. But such a shift would provide a means to sustain the vitality of the growing CSR and SRI movements. Although other paths may exist, a reinvigorated fidelity to trust provides a simple route to escape the looming tragedy of transparency.