# CORPORATE LAW AND THE LIMITS OF PRIVATE ORDERING

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Solomon-like, the Delaware legislature in 2015 split the baby by amending the Delaware General Corporation Law to authorize forum-selection bylaws and to prohibit charter or bylaw provisions that would shift to the plaintiff defense costs incurred in connection with shareholder suits that were not successfully concluded.[1] In so acting, the legislature gave managers something they wanted, a way to deal with the scourge of multi-forum litigation,[2] while pacifying the local bar that feared lucrative shareholder suits would disappear because of the chilling effect of a loser-pays rule for shareholder suits. The legislature acted after the Delaware Court of Chancery held in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*[3] that the board could, without the concurrence of the

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1. S. 75, 148th Gen. Assemb. (Del. 2015), amending DEL. CODE ANN. tit. 8, §§ 102, 109 (2015) (prohibiting fee-shifting provisions in articles of incorporation or bylaws, respectively) and adding DEL. CODE ANN. tit. 8, § 115 (2015) (authorizing forum-selection bylaws), was signed by Governor Jack Markell on June 24, 2015.

2. From 1999 to 2000, only 12 percent of deals had litigation, and most of the deal litigation related to Delaware firms was in Delaware. C.N.V. Krishnan et al., *Shareholder Litigation in Mergers and Acquisitions*, 18 J. CORP. FIN. 1248, 1250–54 (2012). Furthermore, this litigation decreased the likelihood of a deal closing, but also increased returns on the deals that closed, so that overall it was associated with an increased return for the deals. *Id*. at 1254. Deal-focused litigation has since changed. For example, Cain and Davidoff report that in 2012 there were 121 transactions over $100 million in value, and that 111 of these deals experienced deal litigation. Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013* 1–2 (The Ohio State Univ. Moritz Coll. of Law Pub. Law & Legal Theory Working Paper Series, No. 236, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2377001; *see also* ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2012 M&A LITIGATION 1 (2013), *available at* https://www.cornerstone.com/GetAttachment/9d8fd78f-7807-485a-a8fc-4ec4182dedd6/2012-Shareholder-Litigation-Involving-M-and-A.pdf (finding that in 2012, shareholder suits accompanied 93 percent of merger and acquisition transactions in excess of $100 million). Moreover, about 50 percent of these deals also resulted in litigation in more than one jurisdiction. Cain & Davidoff, *supra*, at 2. For speculation on the underlying causes of these developments, see generally John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605 (2012); Sean J. Griffith & Alexandra D. Lahav, *The Market for Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053 (2013); Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753 (2012).

3. 73 A.3d 934, 939–41 (Del. Ch. 2013).

shareholders, adopt bylaw provisions that permitted the corporation to choose the forum in which a shareholder-initiated suit would be maintained. Subsequently, in *ATP Tour, Inc. v. Deutscher Tennis Bund*,[4] the Delaware Supreme Court, relying on the reasoning in *Boilermakers*, upheld a board-adopted bylaw that abandoned the long-maintained American Rule (whereby litigants bear their own litigation costs) to instead assign the suit's defendant's expenses (which in a derivative suit would include the corporation's costs) to the plaintiff if the suit proved unsuccessful. Because such private ordering in the shadow of shareholder suits is not isolated to Delaware,[5] the peace that the plaintiff's bar has now reached via the Delaware legislature may only shift their once Delaware-focused angst to other states. Moreover, the Delaware legislation is narrowly focused; it remains to be seen whether board-adopted bylaws can condition shareholder suits on a range of other actions that impede shareholder suits, such as standing criteria that mandate size and length of a plaintiff's shareholdings or even mandate arbitration of such claims.

*Boilermakers* and *ATP Tour* actually pose a more fundamental question than the substance of the board-adopted bylaws. In their wake there lurks the much larger question: are there limits on the power of the board of directors to act through the bylaws to alter the rights shareholders customarily enjoy? Stated differently, can the board of directors' authority to amend the bylaws extend to changing both the procedural and substantive relationship that shareholders have with the corporation and the board of directors? This is the focus of this Article.

*Boilermakers* and *ATP Tour* each reasoned from the perspective that the shareholders' relationship with the corporation, and in turn their relationship with the board of directors, are contractual so that much of the shareholders' rights can be understood to flow from certain organic documents, and most significantly and pervasively from the company's bylaws.[6] For Delaware corporations, the board enjoys the power to amend the bylaws only if granted that authority in the articles of incorporation.[7] With that grant of authority to the board present in both *Boilermakers* and

4. 91 A.3d 554, 557–58 (Del. 2014).

5. For a rich account of a challenge in Maryland to a board requiring, among other items, that shareholder disputes be handled through arbitration, see Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. (forthcoming 2016).

6. *See ATP Tour*, 91 A.3d at 557–58; *Boilermakers*, 73 A.3d at 939–41.

7. DEL. CODE ANN. tit. 8, § 109(a) (2015). In contrast, most states follow the pattern of the Model Business Corporation Act and grant both the board of directors and the shareholders coextensive authority to adopt and amend the bylaws, subject to the articles of incorporation restricting the board's authority. MODEL BUS. CORP. ACT ANN. § 10.20(b)(1) (4th ed. 2013).

*ATP Tour*, it was a short step for each court to conclude that the board's action was pursuant to the contract shareholders had with their corporation, and that the power of the board to amend the bylaws carried with it the power to amend the shareholders' rights.[8] Repeatedly, the analysis used by each court referenced the contractual relationship the shareholders had through the articles of incorporation and the bylaws with their corporation;[9] hence, that contractual relationship was subject to modification through the mechanism provided by the web of the articles of incorporation's authorization for the board to amend the bylaws. This Article argues that this analysis is wrongly premised. The Article develops two broad points: (1) that the shareholder's relationship is more than just a contract, and, (2) even if the relationship were contractual, bedrock contract law does not support the results reached in *Boilermakers* and *ATP Tour*.

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8. *See ATP Tour*, 91 A.3d at 557–58; *Boilermakers*, 73 A.3d at 939–41. For an incisive analysis of why consent cannot be found by the shareholders' grant of authority to the board to amend the bylaws, see Deborah A. DeMott, *Forum-Selection Bylaws Refracted Through an Agency Lens*, 57 ARIZ. L. REV. 269, 275 (2015) (explaining that a provision in the articles of incorporation authorizing the board to amend the bylaws is too attenuated to constitute consent in part because "nothing in the DGCL or any other Delaware statute explicitly alerts investors to possible downstream impediments on [shareholders'] right to sue").

9. Delaware's invocation of contract principles in this context is illustrated by the following:

> [T]he board itself may act unilaterally to adopt bylaws . . . . Such a change by the board is not extra-contractual simply because the board acts unilaterally; rather it is the kind of change that the overarching statutory and *contractual* regime the stockholders buy into explicitly allows the board to make on its own. In other words, the . . . stockholders have assented to a contractual framework established by the DGCL and the certificate[] of incorporation [authorizing the board to adopt bylaws] that explicitly recognizes that stockholders will be bound by bylaws adopted unilaterally by their board[].

*Boilermakers*, 73 A.3d at 956 (emphasis added) (citations omitted).

In *ATP Tour*, the Court noted that because corporate bylaws are "'contracts among a corporation's shareholders,' a fee-shifting provision contained in a . . . validly-enacted bylaw would . . . not be prohibited under Delaware common law." *ATP Tour*, 91 A.3d at 558 (quoting Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) ("Corporate charters and bylaws are contracts among a corporation's shareholders; therefore, our rules of contract interpretation apply.")).

*Boilermakers* also relies on the same broad, undeveloped statement in *Airgas*, as well as a much earlier and less convincing decision, *Lawson v. Household Finance Corp.*, 152 A. 723, 728 (Del. 1930), upholding the imposition of a right-of-first-refusal transfer restriction set forth in the bylaws where the corporate statute expressly authorized bylaws to restrict shares, and the shareholder acquired the shares with full notice of such restriction. *Boilermakers*, 73 A.3d at 939 n.7. Thus, the substantive authority for the bylaw restricting transfer was expressly provided by state statute, so that neither *Lawson*'s facts nor its reasoning lend themselves to anything other than a substantive interpretation of a state statute.

## I. THE VULNERABILITIES OF THE "NEXUS OF CONTRACTS" PARADIGM

The seeds for *Boilermakers* and *ATP Tour* were sewn three decades ago with the metaphorical pronouncements by many commentators that the corporation is but a "nexus of contracts."[10] The expression is impactful because it is more than just a metaphor; it has substantive bite. The expression not only sets the course for what should be the content of organization law (i.e., principles should be what the parties would have agreed upon if bargaining were costless), but more significantly provides escape from those principles by allowing the parties to "opt out" of norms that are thereby default rules.[11] Building on Coase's perspective on why firms exist (the view holds that labor, suppliers, customers, investors, and managers arrange their activities to their optimal benefit), some leading scholars embrace private ordering as the desired norm within corporate law. In a world of private ordering, the state corporate statute is understood to have the limited role of providing default rules in those instances where the parties have not otherwise specified how their affairs or activities are to occur.[12] Corporate participants may well not specify all

10. While the corporation-as-contract banner was carried by many, Frank Easterbrook and Daniel Fischel, as well as the celebrated article by Professors Jensen and Meckling, provided the intellectual foundation on which others built their multiple contributions. *See generally* Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983); Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982); Michael C. Jensen & William. H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). The perspective embodied in the metaphor is now well entrenched. *See, e.g.*, JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 22 (2008) ("It has long been recognized . . . that the corporation . . . should be viewed as a 'nexus of contracts' or set of implicit and explicit contracts."). For an insightful analysis of the nuance that separates the early scholars whose collective work propelled the contractarian view behind the nexus-of-contracts metaphor, see William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989).

11. Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1550–51 (1989) (arguing that so viewing corporate law is too narrow a view, as the corporation is thereby envisioned as merely a vehicle for wealth maximization, and the multiple other contributions that flow from society's authorizing their existence are thus ignored). If courts are to be drawn into mediating the extent to which private ordering prevails within business organizations, this necessarily raises concerns regarding whether the court has the institutional competence to fully evaluate the social implications of attempted departures from statutory norms, particularly in the complex setting of the public corporation. *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1620–21 (1989) (discussing how a discussion of the mandatory-enabling nature of corporate law necessarily implicates the institutional competence of courts, as the question is a choice between relying on prophylactic rules and permitting private ordering with ex post judicial review for fairness).

12. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1426 (1989) ("[Nexus of contracts] is just a shorthand for the complex arrangements of many sorts that those who associate voluntarily in the corporation will work out among themselves.").

aspects of their relationship and accompanying rights and duties; they would avoid setting forth such matters when the costs of contracting reduce the benefits of the privately negotiated rules such that overall the ex ante benefits of the default rule dwarf the ex ante burdens of the customized rule.[13] In any case, the default rule is tailored toward what the legislature believes most, but not all, of an organization's stakeholders would agree to if contracting were efficient.[14]

To nexus-of-contracts adherents, corporate rules are not mandatory but default rules; the parties are free to tailor the relationship to their own particular needs.[15] Thus, within the nexus-of-contracts metaphor, forum selection, fee shifting, and mandated arbitration are just some areas, among many others, where parties can best tailor their needs through their negotiations and agreement. Broadly stated, to the nexus-of-contracts crowd, corporate law as provided by the state is merely facilitative of private bargaining. Pursuant to this view, corporate law is not public, but private law.[16] In such a realm, the only issue in doubt is what constitutes consent among the affected parties; after all, it is bargaining that then results in the consent that Coase and contract theory so heavily depend upon as the basis for the efficiency that lies at its end. Consent is inextricably linked to another central assumption of such private ordering: the belief that the terms of the resulting contract will be fully priced into the shares.[17] Even here, the champions of the nexus-of-contracts approach salve any unease about there being meaningful consent by their obeisance to the efficient pricing of the "contracts" outcomes being reflected in the price of a firm's securities.[18] That is, owners and others—for example, creditors—who believe the "bargain" may be tilted against them can overcome any anticipated disadvantage by discounting charges based on

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13. The cost of contracting is not the only reason for contracts to be purposely incomplete. *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 127 (1989) ("[W]hen one party to a contract knows more than another, the knowledgeable party may strategically decide not to contract around even an inefficient default. Because the process of contracting around a default can reveal information, the knowledgeable party may purposefully withhold information to get a larger piece of the smaller contractual pie.").

14. Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1847 (1989) (observing that departure from the statutory norm is most likely with respect to rules addressing problems whose "resolution varies significantly from company to company and when the desirable solution depends on particular features of each company that are better known to the parties involved than to public officials").

15. Easterbrook & Fischel, *supra* note 12, at 1434–36.

16. *See id.*

17. *See id.* at 1430; *see* Coffee, *supra* note 11, at 1623 (noting that a desirable requirement of contracting within the corporate law setting is that terms be accurately priced).

18. *See, e.g.*, Easterbrook & Fischel, *supra* note 12, at 1430.

the expected costs of any resulting unfairness or harmful contractual provision. Thus, any expected advantage gained by one party in bargaining can be expected to give rise to counterparty discounting (e.g., paying less for the shares or charging more for the money, goods, or services exchanged).

Such pricing seems unlikely for multiple reasons. First, accurate pricing of an ownership interest in a corporation can be expected to occur only for corporate shares traded in a market that is not only informationally efficient but fundamentally efficient. This requires that there be evidence that a security's price reflects the intrinsic value of the bundle of rights represented by share ownership. This level of efficiency is not even believed to exist among the most ardent supporters of the efficient market hypothesis.[19] And, even if this condition were to exist in well-developed markets, vast numbers of corporations do not trade in such a market, if they trade at all. Second, any such pricing occurs only for those who acquire their shares after the amendment has been adopted; for earlier holders, the element of surprise necessarily accompanies unilaterally adopted bylaws. To be sure, there are a range of negative value actions that boards may embrace through the bylaws, so that the average estimated cost of such future action may be within the pricing process of any company's shares. However, when a particular company held by a shareholder does embrace a negative-value bylaw amendment, there is no overall wealth impact on the individual shareholder if that shareholder holds an efficient portfolio. The realized negative-value bylaw's impact for one company in that portfolio is offset by another equally weighted portfolio company. However, to the extent that many companies ultimately follow course in adopting the negative-value bylaw amendment, the earlier estimate will prove wrong, so that the shareholder did not discount enough when acquiring the shares. Thus, pricing will not provide ex ante means for shareholders to address this risk of share ownership. Third, a bylaw amendment that deals with shareholder litigation does not necessarily lead to negative value outcomes. For example, fee-shifting bylaws may well insulate corporations from the burdens of abusive

19. We cannot determine whether any market is fundamentally efficient, i.e., efficient such that trading prices reflect the intrinsic value of an asset, because it is not possible to know what is the asset's intrinsic value. *See generally* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970). What we can observe is that information and stock prices can and frequently do interact in ways that suggest informational efficiency, but that does not make the case for the resulting prices being correctly priced in the manner envisioned by the nexus-of-contracts proponents. Additionally, what we can observe translates poorly to enterprises whose ownership interests do not trade on a market at all.

shareholder litigation. On the other hand, the provision may insulate managers from being accountable. Neither of these outcomes can be predicted when the shareholder acquires shares with only the awareness that the board of directors can unilaterally amend the bylaws to accomplish a constellation of objectives. Even the most efficient market cannot be prescient; thus, serious information deficiencies eviscerate the likelihood of pricing the impact of the board's power over the bylaws. Because the term cannot be priced, it is a term that cannot be seen to enjoy consent in any form.[20]

Frank Easterbrook and Daniel Fischel were early advocates for viewing corporate law as consensual. They placed much of their embrace on the nexus of contracts as being necessary for business enterprises to be "adaptive," since organizations, and their actors, are themselves dynamic because they exist and are buffeted by an ever-changing business environment.[21] Thus, businesses demand adaptive actors, and the law should accommodate this reality.[22] To this end, they reason that owners and managers must be able to tailor their relationship to ever-changing circumstances.[23] It is not clear from this reasoning why, at the same time that actors enjoy flexibility with respect to the conduct of the corporation's business, their relationship to the firm and its shareholders, as well as their duties to each, cannot be predictable. There appears nothing inconsistent with a body of rules that allow change through deliberation and ultimately consent as opposed to unilateral action. Nor does it appear inconsistent for some actors, such as boards of directors and their appointed officers, to act pursuant to broad norms, such as the pervasive business judgment rule that accords great deference to corporate actors, while at the same time carving out precise areas, developed below, where meaningful consent to act is required. Nonetheless, Easterbrook and Fischel observe: "To say that a complex relation among many voluntary participants is adaptive is to say

20. Professor Coffee, in addressing a more focused contractual freedom issue, finds the parties' ability to opt out of mandatory rules to be a reason that pricing is not possible in such an instance unless it is both transaction-specific and coupled with a duty of good faith. Coffee, *supra* note 11, at 1664. He concludes that this would have no impact on self-dealing transactions, for under even the contract perspective there would be an ongoing requirement on the part of the fiduciary not to engage in unfair dealings with the corporation. *Id.* at 1665. The opposite of a specific transaction is the common immunity shield for directors, such as that authorized in Delaware General Corporation Law § 102(b)(7); the long-term nature of the provision, and the ever-changing undertakings over that time, prevent past experiences from serving as a guide for measuring the provision's costs, so that pricing will necessarily be inaccurate. *See id.* at 1667.

21. Easterbrook & Fischel, *supra* note 12, at 1427–28.

22. *See id.* at 1428.

23. *See id.*

that it is contractual."[24] This statement will most certainly impress contract scholars as an oxymoron. As examined more fully below, an over-arching feature of a contract is the requirement of definiteness. Because of this requirement, contracts as such can hardly ever be adaptive in a way suggested by Easterbrook and Fischel as a desideratum for business organizations. Flexibility within the corporation occurs through a centralized board that operates under an unconstrained corporate charter whose decisions are insulated by overwhelming deference provided by the business judgment rule. The effective check on the board's stewardship is not private ordering but the fact the board's members are elected periodically by the residual owners focused on an objective measurement of performance: share price.[25] Moreover, definiteness cannot be expected to be provided by "wealth maximization" serving as the North Star by which to measure whether expectations are being fulfilled; wealth maximization as a norm is too incomplete to serve as a meaningful reference point of the parties' likely intent.[26] Thus, contract provisions do not provide the desired adaptive feature of corporate organizations, whereas corporate governance does.

Consent is a necessary feature for the contractual paradigm. Simply stated, a contract arises when and only when there is a meeting of the minds on the parties' respective undertakings. Consent and contracting can be found within the shareholder's relationship to the corporation. However, that relationship is richer and potentially more fluid than a contract because of a set of governance arrangements and procedures that permeate corporate statutes and thereby define corporate organizations.[27] Corporate organizations operate, and are governed, by a mixture of mandatory rules, contractual undertakings, fiduciary obligations, and foremostly through highly fluid governance mechanisms that link officers, directors, and residual claimants.[28] The pervasive presence of mandatory rules and fiduciary duties that are applied ex post, plus the fact that many rules within the corporation can be the product of unilateral action by the corporation's organizers and officials, erodes the descriptive power of the

24. *Id.*

25. *See* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 150–52 (2009).

26. Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1452 (1989).

27. *See, e.g.*, Lawrence A. Hamermesh, *Consent in Corporate Law*, 70 BUS. LAW. 161 (2014) (arguing that consent is also a necessary component of governance).

28. *See* Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1487 (1989).

contract metaphor. No consent is present for a mandatory rule or fiduciary duty to apply, and unilateral action necessarily means action taken without consent to that action. In combination, these rules and duties reject the nexus-of-contracts paradigm.

In the business organizational setting, consent so necessary for contracting can more easily be found within small groups. For example, contract-like construction of the "bargained-for" relationship appears in the case law of close corporation law.[29] On further examination, most close corporation decisions invoking the rhetoric of contractual expectations are little more than holding individuals to the governance arrangement, as contrasted with a particular outcome they chose for themselves, even in instances where it would appear the legislature did not formally authorize that arrangement. Such case holdings or approaches do not place the parties solely within the realm of contract law. Quite the opposite occurs: contract rhetoric is used to support a governance norm, as most decisions involve the construction of an agreement among the parties and more generally support their view of the organizational arrangement for fulfilling their mutual aspirations. Thus, in the classic *Galler v. Galler*,[30] the focus of the court was the validity of an agreement among the stockholders where, similar to other cases,[31] the resolution of the dispute among owners was substantially based on the only rights that would be impacted by such enforcement, being solely those rights of the agreement's signatories and their heirs. While appearing to resolve the matter along contractual lines, it emphasized there were no third-party interests or provisions of the corporate statute that would be impacted.[32] The court's concern for the interests of third parties, such as creditors or minority holders, underscores that corporate norms exist for interests outside the signatories to the agreement. The corporation is not exclusively a privately-ordered arrangement.

Statutes commonly enable company shareholders to tailor their arrangements within the corporate statute. In some states, corporations meeting statutory conditions that qualify them as "close corporations" can alter their governance structure, such as abolishing the board of directors or providing dissolution upon the request of any stockholder.[33] Consent to

29. *See generally* 3 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 14.13 (3d ed. 2010).

30. 203 N.E.2d 577 (Ill. 1964).

31. *See* COX & HAZEN, *supra* note 29, § 14.5.

32. *Galler*, 203 N.E.2d at 585.

33. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 350–51, 354 (2015); MODEL BUS. CORP. ACT § 7.32 (2007).

such arrangements occurs dually through a super-vote requirement introduced after the corporation has been formed and due notice of the deviation appearing on the share certificates.[34] Even when the parties do not follow the prescribed procedure for opting out of discrete features of the general corporation law, the courts uphold their agreement by reasoning that the authorization is enabling and the statutory norm is not inflexible, particularly when no third party or public policy is adversely affected.[35] However, what is authorized to be changed by such consent is the governance structure the parties have mutually chosen. In doing so, their consent is specific as to the particular change in the "default" rule provided by statute.

The frequent resort in the close corporation setting to protecting "reasonable expectations" of shareholders[36] falls short of reducing the corporation to a web of contracts. To be sure, the most enduring contribution of scholars who have written persuasively that close corporations should be conceptualized as incorporated partnerships is not the underused provisions some corporate statutes accord statutory close corporations,[37] but their awakening courts to the unique vulnerabilities of close corporation shareholders. These are vulnerabilities of the type that call for equitable protection. The touchstone for judicial protection, whether in the form of monetary relief or ordering dissolution, is whether the majority has substantially defeated the reasonable expectations of the minority holder.[38]

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34. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 342–43 (2015); MODEL BUS. CORP. ACT § 7.32(b) (2007).

35. *See, e.g.*, Ramos v. Estrada, 10 Cal. Rptr. 2d 833, 835–38 (Ct. App. 1992) (holding that a voting agreement among all shareholders was valid even though the company did not fulfill statutory requirements to be a statutory "close corporation," and the statute authorized such an arrangement for "close corporations"); Zion v. Kurtz, 405 N.E.2d 681, 684–86 (N.Y. 1980) (holding that an agreement among parties expressly authorized for corporations qualifying as close corporations in Delaware is valid when there are no intervening third-party rights).

36. *See, e.g.*, Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Changes, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717 (2002) (reviewing cases anchoring protections to minority holder in the minority holder's reasonable expectations); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699 (1993) (reviewing the role that reasonable expections play in granting relief under dissolution statutes).

37. *See* 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE § 1.29 (rev. 3d ed. 2015) (setting forth data reflecting that a tiny fraction of newly formed corporations opt into statutory close corporation regimes afforded by various states).

38. COX & HAZEN, *supra* note 29, §§ 14.13, .16. This approach is not without its interpretative problems. Reasonable and intelligent minds can easily disagree over the content of rules based on the probable reasonable expectations of business owners. This is classically illustrated in *Jordan v. Duff & Phelps, Inc.*, 815 F.2d 429 (7th Cir. 1987), where Judges Frank Easterbrook and Richard Posner reached conflicting positions regarding whether an at-will employment contract would allow the

Protecting "reasonable expectations" has the ring of contract law, so that we might conclude that, at least in the close corporation, contract and not governance is central because the protected interest arises from the "bargain." But it is equally persuasive to conclude that in the close corporation setting corporate law and contract law reach the same conclusion regarding what is the optimal and just result. Nonetheless, where a fiduciary relationship exists, it exists not because of an agreement to be fiduciaries but because public policy considerations impart to the parties fiduciary-based rights and obligations. This truly transcends private ordering.[39] Contract law to a limited extent has a fiduciary basis as well, albeit the demands of the duty are not as pervasive as we find in corporate law. Consider that "in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[40] For example, Professor Melvin Eisenberg reasons that just as UCC provision 2-302 embraces the doctrine of unfair surprise so that a contractual term that is inconspicuous or unclear is rendered unenforceable if a party should have known it could be used to violate another party's fair expectation, so it is that courts protect known expectations in close corporations from being unfairly surprised.[41] These rules may easily be divined from the parties' probable expectations, but to do so suggests they are alterable by the parties' agreements. Much like the unalterable implied covenant in contracts, the fiduciary duties of corporate organizations are not anchored in consent and therefore are not alterable. Thus, while sounding in contract, the close corporation cases that are built on

employer to terminate an employee so that the corporation could then exercise its right to acquire the employee's shares at their book value, when the company was on the threshold of being acquired at a significant premium. Both judges premised their conflicting outcomes on the bargain the parties would have struck, with Judge Easterbrook concluding their bargain would have included an implied fiduciary duty that would constrain the employer from terminating the employee and thereby confiscating the employee's share of the expected acquisition premium. *Id.* at 431–43. Judge Posner believed the hypothetical bargain would not have included such a duty. *Id.* at 444–52.

39. *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 887 ("The terms of an express agreement are surely not irrelevant to the fiduciary obligation analysis, but once a court concludes that a particular relationship has a fiduciary character, the parties' manifest intention does not control their obligations to each other as dispositively as it does under a contract analysis.").

40. Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 167 (N.Y. 1933).

41. Eisenberg, *supra* note 28, at 1464–65 (observing that it is nearly impossible in the close corporation setting "to assess adequately the future costs and benefits in a fluid long-term relationship"). Professor Eisenberg notes that the reticence of courts to enforce liquidation damages clauses flows from a similar concern, namely a contracting party's likely inattention to the clause due to the difficulty, if not impossibility, of fully foreseeing the future consequences of a breach. *Id.* at 1463–64.

understandings and reasonable expectations can, and likely should, be viewed more broadly as necessarily a component of the law of relations among co-owners. The protective feature finds force in the "bargained for" exchange rhetoric, but the efficacy flows instead from what law anchored deeply in public policy believed necessary to protect expectations so as to promote entrepreneurial activity.

*Meiselman v. Meiselman*, a leading case that premised its order of dissolution on the petitioner's reasonable expectations having been defeated, held that the guiding "reasonable expectations" are to be ascertained by examining the entire history and could be altered over time as the shareholders interact and conduct the affairs of the corporation.[42] Of importance in this and other applications of the "reasonable expectations" approach is the element of mutuality. Expectations are those that are not just known but shared. With such awareness, the law's protection against unfair surprise is justified. The role of such mutuality stands in stark contrast to the results reached in *Boilermakers* and *ATP Tour*, where the courts sanctioned resort to a generalized grant of authority to amend a document that historically does not address shareholder litigation to defeat existing substantive and procedural rules for shareholder litigation.[43] Even though contract law protects against unfair surprise, the invocation of the contract analogy in *Boilermakers* and *ATP Tour* welcomes and legitimates the unexpected under the guise of contract law.

The "reasonable expectations" rubric has lessons outside the close corporation setting. Because fiduciary duty law has developed through years of ex post application, its content is informed not solely by what cases have held before but importantly by the specific facts before the court, so that obligations and rights are shaped by the probable expectations of the parties. Fiduciary law efficiently relieves the parties of the burden of providing specification of duties or verification of performance.[44] In the contract context, parties whose contract is incomplete expect they can fill in any gaps that may arise in the future via *self-interested* arms-length renegotiation; their conduct in such renegotiation is constrained only by the existing contractual duty of good

42. Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("[S]hareholder's 'rights or interests' in a close corporation include the 'reasonable expectations' the complaining shareholder has in the corporation.").

43. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557–58 (Del. 2014); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939–41 (Del. Ch. 2013).

44. Daniel Markovits, *Sharing* Ex Ante *and Sharing* Ex Post*: The Non-Contractual Basis of Fiduciary Relationships*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 215 (Andrew S. Gold & Paul B. Miller eds., 2014).

faith and fair dealing.[45] In contrast, if the relationship is a fiduciary one, the law demands that the fiduciary unilaterally adjust to the new circumstances in an "*other-regarding* way" consistent with duties of care and loyalty.[46] Herein lies a fundamental distinction between judging the parties' behavior through the contract lens versus the corporate law lens. Contracts and corporate law are not mirror images, as corporate law's enshrinement of the inquiry causes the protection to be broader than that in contract law, where the protected expectations are derived from the four corners of the contract. Corporate law places an important governor on the directors, officers, and controlling stockholders to modify the relationship with owners.

We can surmise that the ultimate contribution of the contract metaphor in corporate disputes is to frame, if not cabin, the inquiry whether shareholder rights exist. That is, nexus of contracts is more than a metaphor—it's a rule of construction.[47] More significantly yet, it is a rule of construction that, within a world of modern enabling corporate statutes, necessarily constrains shareholder rights and protections. In an environment where private ordering prevails, those in control—the board, officers, and controlling stockholders—enjoy important, and likely unerodible, strategic advantages.[48] First, the informational advantages of those in control permit them not only to time a change to their own advantage, but also to understand better than outside shareholders the full effects of a bylaw change they propose. As a consequence, they can act opportunistically to pursue self-interested ends, the effects of which only they can be fully aware. Second, insiders acting to amend bylaws do not face the formidable collective action problem that outside shareholders incur in moving a bylaw through the approval process. While both boards and shareholders enjoy the right to amend the bylaws, the board being a cohesive body as a practical matter enjoys lower costs and uncertainty when choosing the bylaw course of action. This is certainly the case when the board acts unilaterally via a bylaw amendment, but also is true when it

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45. *Id.* at 218.

46. *Id.* at 218. Tautologically, Easterbrook and Fischel, while championing the nexus-of-contracts perspective, nonetheless recognize that fiduciary law exists to address contractual incompleteness. Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993).

47. *See* Kornhauser, *supra* note 26, at 1451.

48. *See* Lucian A Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682–87 (2007) (collecting evidence on the paucity of contested proxy solicitations, from which he concludes that because proxy contests, whether to elect directors or oppose management proposals, occur infrequently, the vitality of the shareholder franchise to vote is easily overstated).

seeks the approval of the shareholders for the proposed action. Indeed, under corporate law, the board's costs to act are borne by the corporation, whereas the shareholders' cost to act, and most importantly to persuade fellow shareholders, is borne by the activist shareholder. Thirdly, the law tilts heavily against shareholders in American public companies having the right to alter the fundamental structure of the corporation; corporate statutes set forth the basic structure of the corporation subject to countervailing provisions in the articles of incorporation. Thus, if altering the default rule, whereby corporate affairs are managed by or under the direction of the board of directors, the preferred structure must appear in the articles of incorporation. In the United States, unlike in other countries, only the board of directors has the power to initiate amendments to the articles of incorporation. This feature of American corporate law not only reduces the shareholders to a reactive role in defining their governance structure, but also necessarily restricts the area that is a proper subject for shareholder action.

The Delaware Supreme Court's holding in *CA, Inc. v. AFSCME Employees Pension Plan*[49] further constrains the shareholders' authority to amend the bylaws. *CA, Inc.* held that the shareholders' authority to initiate an amendment of the bylaws was limited to matters that are "procedural [or] process-oriented,"[50] so that a bylaw that would encroach upon the managerial authority of the board of directors would be inappropriate.[51] Because this construction was based on the call in the Delaware statute that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided . . . in [the] certificate of incorporation,"[52] if shareholders had the authority to initiate an amendment of the articles of incorporation, shareholders would not be limited to process- or procedurally-oriented matters. Rather, they could initiate, as the board can initiate, a wide range of substantive alterations to the conduct of the corporation's affairs. Since shareholders lack authority in the very area that the board enjoys authority, the shareholders' prerogative to initiate is greatly constrained within a private-ordering environment. Questions regarding the authority to change or opt out of a default rule will therefore be found when it is the board acting to change the rules of the game rather

49. 953 A.2d 227 (Del. 2008).
50. *Id.* at 235.
51. *See id.* at 235–37.
52. *Id.* at 232 (quoting DEL. CODE ANN. tit. 8, § 141(a)).

than the shareholders. It is for this reason that the nexus-of-contracts rubric necessarily threatens shareholder rights and protection.

Further evidence of the uneven balance between the prerogatives of the board of directors to act and the shareholders to alter the rules of governance is once again reflected in *CA, Inc.* Even though the bylaw involved was deemed to be process- and procedurally-oriented, and thus a proper subject for shareholder action, the court nonetheless held that the proposed bylaw was sufficiently general so that it *could* require reimbursement in instances that would be inconsistent with the board's fiduciary obligations.[53] The bylaw proposed in *CA, Inc.* provided that non-management nominees who are elected to the board should be reimbursed for reasonable expenses incurred in their successful contests for office.[54] The Delaware Supreme Court held that because the bylaw could be invoked by a candidate who sought office solely to advance personal, rather than corporate, interests, the bylaw was invalid.[55] In contrast to *CA, Inc.*, when in *Boilermakers* challengers to the board-adopted forum-selection bylaw raised multiple examples where the bylaw could be harmful to the corporation, Chancellor Strine summarily dismissed that line of challenge on the ground that "it would be imprudent and inappropriate to address these hypotheticals in the absence of a genuine controversy with concrete facts."[56] We are left, therefore, with the stark conclusion that shareholder- and board-initiated bylaws do not stand on the same footing, so that the efforts of the former are, despite satisfying a generic inquiry with respect to the subject of the bylaw being a proper one, also subject to ex ante scrutiny for their *potential* inconsistencies with corporate law, whereas the latter bylaws escape such ex ante scrutiny.[57]

A final basis on which to question the contract paradigm in the corporate setting is how contract law and corporate law proceed on very

53. *Id.* at 233–37.

54. *Id.* at 229–30.

55. *Id.* at 238–40.

56. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 940 (Del. Ch. 2013).

57. We might believe that the contrasting approaches between *CA, Inc.* and *Boilermakers* is symptomatic of a larger problem with the architecture of corporate law, namely that the role and prerogatives of the board of directors is believed to be more clearly defined than the role and prerogatives of shareholders. *See generally* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407 (2006). Because corporate statutes are areas where the shareholders enjoy protected rights that are defined with a good deal of precision, it would appear the problem is not a lack of precision, but rather too much precision. This permits the broadly-stated authority of the board to enjoy unrestrained deference, whereas the precise definition of the shareholders' rights has led the courts, erroneously, to not accord similar deference to shareholder rights when mediating conflicts between the broad grant of authority to the board and more selective grants to the shareholders.

different bases for expected behavior on the part of the parties. The nexus-of-contracts approach meshes poorly with corporate law in light of the very different assumptions that surround contracting parties versus the norm corporate law imposes on managers and dominant stockholders. Under bedrock corporate law, directors and officers are to act selflessly when discharging their corporate duties; in contrast, contracting parties pursue wealth maximization through self-interested, individualistic behavior.[58] Whereas directors owe the corporation and owners a duty of loyalty, contracting parties pursue rugged self-interest, with the only governor being the obligations of good faith and fair dealing within the four corners of their contract. It is not possible to fit the contractual paradigm of individual pursuit of gain with the corporate law, where fiduciary obligations police discretionary behavior by managers and controlling stockholders. Principles and perspectives in the rugged contract setting simply do not survive in the relational setting of corporate law.

## II. WHAT'S IN A CONTRACT?

As seen, Delaware courts embrace the board's authority to alter substantive rights, at least those related to shareholder litigation, by unilateral amendment of the company's bylaws. Delaware reaches this result on the premise that the shareholders stand in a contractual relation to the corporation. The power of this assertion flows from the assertion that the shareholders have consented to the board's unilateral amendment of the shareholder right, power, or privilege, as well as the Delaware courts' dignifying the approach by the assertion that the result is consistent with the law governing contracts. This section questions the overriding premise that contract law supports the conclusions reached in Delaware. Without this support, as is concluded here, the unilateral alteration of shareholder rights embraced in *Boilermakers* and *ATP Tour* lacks a legal foundation.

Contract principles occupy a prominent, but well-defined, space in corporate law. The rhetoric of contract law occupies a broader area. The former is a sensible approach to resolving disputes between the corporation and debt-like claimants; the latter is an expedient form of analysis to resolve essentially a matter of internal housekeeping. To understand the divide, consider that Delaware courts have long recognized that the rights of senior claimants, such as bond holders and preferred

58. Coffee, *supra* note 11, at 1658.

shareholders, are exclusively contractual. For example, the rights of the corporation representing the interests of the common stockholders to change the accrued dividends of the preferred holders is determined from the preferred rights, privileges, and preferences as set forth in the articles of incorporation.[59] Similarly, in *Alta Berkeley VI C.V. v. Omneon, Inc.*,[60] the court upheld the lower court's ruling that a conversion of preferred stock into common stock was not a liquidation event that, under the corporation's charter, would trigger the preferred shareholders' contractual entitlement to a liquidation preference payment. The court noted that "unless there is ambiguity, Delaware courts interpret contract terms according to their plain, ordinary meaning," whereupon it held that the conversion in question did not meet the plain meaning requirements of the corporate charter provision that defined what constituted a liquidation event.[61] Charter terms, therefore, were seen as contracts with the preferred holders so that the preferred holders' rights were determined from that instrument's four corners, and there was no application of fiduciary or equitable notions extraneous to the charter. Bondholders' claims sometimes are also contractual, with slight departure from the rigidity of contract law occurring in isolated instances in which courts accord bondholders non-expressed protection via an implied covenant of fair dealing, a concept of corporate law that flows from a fair construction of the debenture itself.[62] The contractual approach in this setting is easily understood to flow from the nature of the bondholder or preferred shareholder's relationship to the corporation, which at its core is not simply that of being a provider of capital but doing so with no greater expectation than that the relationship is adversarial. Thus, self-help in the form of contracting, not paternalism, is the guidepost for such senior claimants.

To be sure, contract-like approaches in terms of interpreting understandings reached within the business are common to resolving disputes raised by residual claimants who, unlike senior claimants, do enjoy the protections of fiduciary obligations on the part of managers and dominant stockholders. For example, in *Centaur Partners, IV v. National Intergroup, Inc.*, the articles mandated a classified board, authorized the

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59. *See, e.g.*, Ellingwood v. Wolf's Head Oil Refining Co., Inc., 38 A.2d 743, 747 (Del. 1944) (stating that in resolving the power to alter the preferred accumulated dividends, "the rights of stockholders are contract rights and . . . it is necessary to look to the certificate of incorporation to ascertain what those rights are").

60. 41 A.3d 381, 385–91 (Del. 2012).

61. *Id.* at 385–86.

62. *See, e.g.*, Katz v. Oak Indus., Inc., 508 A.2d 873, 878–81 (Del. Ch. 1986).

board to establish its own size, and provided that a provision of the articles or bylaws dealing with related matters could be amended only with an affirmative 80 percent vote of the stockholders.[63] The Court, in deciding whether a majority or 80 percent vote was required to expand the board from nine to fifteen, did so by invoking "general rules of contract interpretation."[64] *Centaur Partners*' use of a contract-like approach does not transform the bylaws, or for that matter the supporting articles of incorporation, into a contract. The approach used was little more than a sensible tool to determine what the organic governance documents required. Nonetheless, what underscores each of the above illustrations is the necessity of definiteness in resolving the dispute. That is, each dispute rested upon the underlying documents' being clear and unambiguous with respect to the rights of the parties. Contractual interpretation of documents that arose within a corporation from which the parties' rights and duties are embodied is not equivalent to the corporation itself being a contract or being solely made up of contractual relationships.

Beyond the above highly specific contexts in which contracts impact parties within a corporate setting is the propriety of concluding that such individual contracts are overall an endless and intricate web that renders the entire enterprise a contract. A close analysis of contract law rejects this conclusion.

The great contracts scholar, Allan Farnsworth, states that there are *two* overarching considerations in determining whether a contract exists: did both parties assent to be bound, *and* is their agreement definitive?[65] As will be seen, the latter is a prerequisite for the former. The Restatement (Second) of Contracts also couples both these requirements by providing that "[e]ven though a manifestation of intention is intended to be understood as an offer, it cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain."[66] The requirement of definiteness is essential, as it goes to the central objective of the contract to protect the expectations of the parties when they exchanged promises in forming the contract.[67] Should there be an alleged breach of

63. Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 925–26 (Del. 1990).

64. *Id.* at 928.

65. E. ALLAN FARNSWORTH, CONTRACTS § 3.1 (4th ed. 2004).

66. RESTATEMENT (SECOND) OF CONTRACTS § 33(1) (1981). For sales of goods, definiteness is addressed in U.C.C. § 2-204(3) (2002), where we might consider there is somewhat more flexibility to be found in the statement that an agreement fails for indefiniteness when it does not provide "a reasonably certain basis for giving an appropriate remedy."

67. Consider that the very nature of a contract is "a promise or set of promises for breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."

performance promised by a party, the courts must "determine . . . with some precision" the scope of the promised consideration.[68] And all the greater is the need for specificity when the relief sought for an alleged breach is specific performance.[69] Definiteness has a further role in deciding whether there is a contract. The more terms and conditions the parties have omitted from their agreement, the less likely it is that they in fact intended to enter into an enforceable agreement.[70] Thus, definiteness bears directly on whether there was an intent to contract. Finally, indefiniteness removes the promise from being consideration to support another's enforceable obligation. That is, a promise that as a practical matter is too indefinite to be enforced cannot be sufficient consideration for a counter-promise.[71]

To be sure, contract law does contemplate that the parties to a contract cannot provide for every potential occurrence or event; and, as a practical matter, it can be that not all terms can be set forth at the moment of contracting. Some matters at the moment of contracting may be impractical to specify in the agreement, such as price or quantity in the case of a sale of goods. Thus, it has become an accepted practice, endorsed by the UCC, for courts to fill in certain contractual gaps.[72] Nevertheless, any such gap filling must occur through a predictable means whereby the information that was intentionally omitted can be ascertained.[73] The

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1 SAMUEL A. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1.1 (4th ed. 2015). Thus, absent clarity with respect to performance, it is not possible for the arrangement to be enforceable or to be expected to be enforceable, so that any exchange of promises would be illusory. *See* 1 ARTHUR LINTON CORBIN, 1 CORBIN ON CONTRACTS § 4.1 (Joseph M. Perillo ed., LexisNexis rev. ed. 1993) (noting that vagueness, indefiniteness, and uncertainty as to the terms of an agreement prevent the creation of an enforceable contract).

68. FARNSWORTH, *supra* note 65, § 3.1. In effect, the definiteness requirement is a "necessary limitation on freedom of contract" because a court must be capable of identifying the terms of agreement between the parties before determining if either party has breached it. JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 2.9 (5th ed. 2003).

69. FARNSWORTH, *supra* note 65, § 3.1; *see also, e.g.*, Carr v. Duval, 39 U.S. 77, 83 (1840) (denying request for specific performance on a contract to sell land because agreement was not sufficiently certain for the court to decree with some exactness whether the relief sought was appropriate).

70. PERILLO, *supra* note 68, § 2.9.

71. 1 WILLISTON, *supra* note 67, § 4.32. From time to time courts enforce indefinite contracts where performance has begun and commenced to a state that removes the uncertainty. *See, e.g.*, Cont'l Bank & Trust Co. v. Am. Bonding Co., 605 F.2d 1049, 1054 (8th Cir. 1979) (holding that construction contract was sufficiently definite as a consequence of partial performance by the contractor).

72. *See, e.g.*, Neuhoff v. Marvin Lumber and Cedar Co., 370 F.3d 197, 203–04 (1st Cir. 2004) (noting that it is not required that all terms of an agreement be precisely specified, and that the presence of undefined or unspecified terms will not necessarily preclude the formation of a binding contract); 1 WILLISTON, *supra* note 67, § 4.21.

73. 1 CORBIN, *supra* note 67, § 4.1; *see also generally* Nellie Eunsoo Choi, Note, *Contracts with Open or Missing Terms Under the Uniform Commercial Code and the Common Law: A Proposal for*

classic illustration of this is the so-called requirements contracts, in which quantity or price is not firmly set forth. But with such contracts there is a requirement that the agreement provides "a reasonably certain basis for giving an appropriate remedy."[74] For example, price can be omitted when it is to be a "reasonable price at the time of delivery."[75] Furthermore, the UCC addresses uncertainty with respect to the quantity of goods covered by the requirements contract by conditioning their validity on there being a stated estimate for volume or what is normal or otherwise comparative output or requirements of the party, as well as imposing a broad duty of good faith on the parties. These steps are what prevents the undertaking from being illusory.[76] Of interest for the purpose of this Article is that outside the sale-of-goods context, courts regularly take a less flexible approach to address indefiniteness within the agreement,[77] limiting any gap filling to immaterial terms of the agreement.[78] That is, courts are less likely to find a contract when a material term is not specified outside the sale-of-goods context.

Corporate law also responds to overreaching in requirements contracts. In a classic corporate law case, *Globe Woolen Co. v. Utica Gas & Electric*

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*Unification*, 103 COLUM. L. REV. 50 (2003) (reviewing how the UCC and courts embrace "gap fillers" and "default rules" to address indefiniteness in *specific* areas such as price, place of delivery, and time of delivery).

74. U.C.C. § 2-204(3) (2002). Courts have, however, been reluctant to extend this approach outside the sale of goods. *See* FARNSWORTH, *supra* note 65, at 211 (emphasizing this point by way of limiting the scope of requirements contracts by courts being unwilling to extend the approach to rental contracts).

75. U.C.C. § 2-305(1) (2002). The code therefore provides an objectively identifiable external standard for performance. A similar approach is embraced for the timing of performance via the "within a reasonable time" standard. *See id.* § 2-309(1); *cf.* Seinfeld v. Slager, Civil Action No. 6462-VCG, 2012 WL 2501105, at *10–14 (Del. Ch. June 29, 2012) (holding that because the Stock Incentive Plan failed to include objective standards for allocating grants and instead left grants to the discretion of the board of directors, the shareholder approval of the plan and the terms of the plan itself could not insulate the directors from a suit alleging self-interested behavior in granting options to themselves).

76. FARNSWORTH, *supra* note 65, at 83–84; *see also generally* John C. Weistart, *Requirements and Output Contracts: Quantity Variations Under the UCC*, 1973 DUKE L.J. 599 (providing a comprehensive examination of pre-UCC case law as guidance for the meaning and importance of "good faith" in addressing open-ended quantity in commercial requirements and output contracts).

77. Choi, *supra* note 73, at 52.

78. Among the terms deemed material are payment terms, specific price, duration of agreement, and quality of work. PERILLO, *supra* note 68, § 2.9; *see also* Giacobbi Square v. PEK Corp., 670 P.2d 51, 53 (Idaho 1983) (emphasis omitted) ("A contract must be complete, definite and certain in all its material terms, or contain provisions which are capable in themselves of being reduced to certainty."); Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1643–44 (2003) (noting that the requirement of definiteness is well entrenched in the case law and a basis for dismissing alleged breach-of-contract claims).

*Co.*,[79] Judge Cardozo held the director's duty of loyalty was breached by the director, Maynard, remaining silent and not warning his fellow directors that a contract the board had approved required the utility to provide at a fixed cost all the power needs of the mill regardless of the customer's usage.[80] The evidence indicated that after the contract was entered into, the customer, who was controlled by Maynard, substantially changed its operations so that significantly greater electricity was to be supplied by the power company than was the customary usage during the period leading up to the requirements contract being formed.[81] The law of contracts and *Globe Woolen Co.* each reject the notion that directors can exploit open-ended authority so as to materially affect the other party. This conclusion is directly contradictory to the notion that the board has authority to act unilaterally through the bylaws to complete earlier unspecified material matters.[82]

As seen, in appropriate instances, courts complete contracts in important and necessary ways by supplying missing terms by implication.[83] However, implication does not erode the importance of definiteness for a contract to exist. Courts act to supply the implied term only when persuaded that "the language of the agreement does not cover the case at hand," and that the implied term is in furtherance of a *definitive* promise of performance.[84] Thus, contract law does not permit the requirement of definiteness, even in the instance of a requirements contract, to be satisfied through the fiat of the well-understood implied covenant of good faith and fair dealing that exists in all contracts.[85] Application of this implied covenant must occur within the agreement so that what is implied is guided by a definite subject matter, and therefore the implied covenant cannot itself be the means to redeem what would

79. 121 N.E. 378 (N.Y. 1918).

80. *Id.* at 380.

81. *Id.* at 379.

82. *See* Gordon, *supra* note 11, at 1573–78 (reasoning that if such shareholder-focused protections are to be altered, they should occur in the initial charter so that they can be both "frozen" and initially priced); *see also* Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1829, 1837 (1989) (concluding that private ordering should not occur via amendments to the charter as, unlike private ordering in the initial charter, they cannot be priced efficiently).

83. *See supra* note 72 and accompanying text.

84. FARNSWORTH, *supra* note 65, § 7.16.

85. Despite the broad recognition of the existence of the implied covenant of good faith and fair dealing, in practice this is an underenforced norm. *See* Paul MacMahon, *Good Faith and Fair Dealing as an Underenforced Legal Norm*, 99 MINN. L. REV. 2051, 2052 (2015). A similar complaint is made of fiduciary duties in corporate law. *See, e.g.*, Julian Velasco, *The Role of Aspiration in Corporate Fiduciary Duties*, 54 WM. & MARY L. REV. 519, 522 (2012).

otherwise be open-ended authority for one of the parties to act.[86] Thus, we find that courts, sometimes invoking public policy concerns, deem an agreement unenforceable because of indefiniteness where it reserves to either party "a future unbridled right to determine the nature of . . . performance."[87] Moreover, the context in which the implied covenant operates is important. In a purely contractual setting, good faith does not proscribe self-interested behavior.[88] But in the corporate context, as discussed earlier, when that conduct is carried out by one deemed a fiduciary, not only is self-interested behavior proscribed, but the burden of proof is also on the fiduciary to establish fairness.[89]

Furthermore, it is not possible to address the open-endedness of the shareholder "contract" with the corporation and its board of directors by the fiat of relying on income or wealth maximization to provide the necessary definiteness that will illuminate the path by which obligations and rights are determined. If the parties' intent is the ultimate focus, as it is in contract law, income or wealth maximization is simply too incomplete in itself to guide any determination of the parties' probable intention.[90] Certainly this conclusion is the case in the context of the corporate organization, where procedures, such as the periodic election of directors, form the mechanism for accountability. Any argument that the relationship among directors, officers, and shareholders is guided by the contract set forth in, for example, the bylaws, is overcome by the multiple features of corporate statutes that provide the means for change, accountability, and discipline through governance mechanisms, not the terms of an "agreement."

## III. CORPORATE LAW IS PUBLIC, NOT PRIVATE, LAW

As developed above, there are multiple bases for disagreeing with the nexus-of-contracts view of the corporation. The focus in this section is to take issue with the foundational belief held by the nexus-of-contracts

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86. *See* FARNSWORTH, *supra* note 65, §§ 7.16, .17.

87. 1 WILLISTON, *supra* note 67, § 4:21; *see* 29 WILLISTON, *supra* note 67, § 74:16; *see, e.g.*, Lahaina-Maui Corp. v. Tau Tet Hew, 362 F.2d 419, 425 (9th Cir. 1966) (holding that the subordination provision that gave the lessee an option to encumber the lessor's property with lien, indefinite in amount, to secure loan(s) with an unspecified rate of interest, term, and manner of payment, without further specifying uses to which the loan proceeds could be directed, was not enforceable).

88. *See supra* note 58 and accompanying text.

89. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 900.

90. Kornhauser, *supra* note 26, at 1452–53.

school that corporate law is so private that it is subject to wholesale private ordering.[91] It is the view that corporate law is solely private, with corporate statutes merely filling in the blanks, that empowers decisions, such as *Boilermakers* and *ATP Tour,* holding that rights once held by an owner can be altered as the managers may agree.[92] In contrast to this view, if corporate law is understood as significantly public law and not private law, the ticklish questions of consent among the parties allegedly involved in the "contracting" process need not be addressed. That is, if corporate law is understood to enjoy substantial public features, then at least our assumptions should change regarding the board of directors' authority to unilaterally change such public norms. Hence, the question of consent, or power to impose on another a requirement, need only be addressed if a matter is one deemed of solely private contract-like arrangements. The threshold question therefore is what areas of corporate law are beyond the reach of the board of directors?

Corporations are unlike partnerships. Corporations do not arise solely by consent. A corporate entity requires completing at least a few modest formalities for its creation. Such formalism is required for all entities that seek limited liability for their owners. Limited liability is clearly a private benefit to the owners enjoying this status. Limited liability, however, does much more, as it produces public benefits including stimulating

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91. The public-private law distinction used in this Article is admittedly an overstatement of the contract law-corporate law divide. Contract law facilitates private ordering so that within fairly broad rules the parties can enter into private arrangements that impose mutual obligations and benefits. As used here, public law embodies rules that exist to serve societal objectives that transcend individual actors. A commercial example of public law includes the numerous conditions of the US securities laws for which Congress has expressly provided that the terms cannot be waived. *See* 15 U.S.C. §§ 77n, 78cc (2014). The rules exist to, among other things, stimulate economic growth and facilitate the efficient allocation of resources. The greater good served by these twin objectives underlies the anti-waiver provisions of the securities laws. To be sure, contract law does embrace a set of rules for there to be an enforceable obligation so that their existence also can be seen as public law. For example, as discussed above, the requirement of definiteness of consideration must be satisfied for there to be an enforceable obligation. Contract law undoubtedly produces a public good in terms of economic stability and economic growth. Thus, to label contract law as private law is admittedly not precise but provides a basis to frame the following: there are features of contract law that cannot be altered by the parties' agreement. As developed in this Article, the requirement of definiteness is not a matter that the parties can waive if they are to have a contract. Indeed, it is tautological to argue that the parties can agree to an indefinite level of performance, since there cannot be an agreement if parties do not know to what they have agreed. Hence, the use of "public law" in contradistinction to "private law" refers to features of a body of law, in this case corporate law, that have such strong societal benefits that they are beyond private ordering, just as some elements of contract law, such as the requirement of definiteness, cannot be waived. Thus, private ordering can definitely occur within the corporation; but, as argued here, there are multiple features of corporate law, many more than exist in contract law, that are beyond private ordering.

92. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 557–58 (Del. 2014); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939–41 (Del. Ch. 2013).

entrepreneurial activity and commerce generally. These public benefits are thus subsidized by limited liability. To be sure, the tangible burdens of this subsidy are provided not by the state, but by creditors who accept the risk that their claims may not be fully satisfied. Nonetheless, it is the state that sets the default rule of limited liability. Another subsidy the state provides is the friction it introduces into dissolving the entity. Corporations are not nearly as fragile as partnerships, whether or not at will. This produces the public benefit of facilitating capital formation, as friction in the path of withdrawing capital is favorably regarded by those who wish to see stability within the firm, so that capital raised can be devoted to the causes represented to investors by the firm's promoters.[93]

Moreover, legislatures have enacted restrictions on corporations' powers to make distributions to their owners.[94] These limitations form a bulwark against the erosion of interests creditors have in the corporation's assets that otherwise could be subverted through distributions to owners in the form of dividends or share repurchases. To be sure, creditors can negotiate additional protections, but the costs of so doing may exceed the expected benefits. Furthermore, small creditors may not find one-off negotiations efficient. For at least this group of creditors, the minimum protection provided by the statute provides a first line of defense. Such creditor protection is public law, as it encourages credit to be extended and priced with a view toward promoting economic activity. Similarly consistent with the public nature of corporate law is how courts weigh the interests of non-shareholders when considering whether to bend the traditional corporate rules. For example, in considering whether to disregard the direct-derivative distinction for a shareholder suit in the close corporation, the absence of harm to creditors is an important consideration in allowing a minority holder to maintain as a direct action a suit that customarily must be brought on behalf of the corporation as a derivative suit.[95]

Similarly, fiduciary obligations, some anchored in corporate statutes and most developed at common law, protect the interests of shareholders from harmful overreaching and sometimes the directors' or officers' ineptitude. The norms that flow from litigation's enforcing fiduciary standards strengthen sensible management of firms and thus contribute to

93. *See* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. Rev. 387, 389 (2003).

94. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 160, 170 (2015); MODEL BUS. CORP. ACT § 6.40 (2007).

95. *See, e.g.*, Barth v. Barth, 659 N.E.2d 559 (Ind. 1995) (following § 7.01 of the ALI's Principles of Corporate Governance).

increased economic activity. The norms themselves shape best practices and in that way reduce agency costs as well as uncertainty. Each in turn yields a public benefit. Fiduciary duties, therefore, are hardly private, as they yield important externalities—their enforcement not only compensates those injured by misconduct, but also promotes investment by establishing investor-friendly norms to which managers must conform. In their absence, investors would demand a higher return, thus raising the cost of capital across the board, as firm managers and controlling stockholders may be unable to signal effectively, and never costlessly, their lower propensity to misbehave.[96] Thus, enforceable fiduciary duties fill this gap and serve the public interest by lowering the cost of capital. Note here as well that the weakening enforcement of these norms necessarily weakens the norms themselves and erodes their public benefit.

Consider that shares may be subject to private arrangements restricting their transfer; this would suggest only private ordering. But private ordering has no impact on a transferee without knowledge of the restriction. Since the transferee of shares is not within the "web" of the corporation, it is not possible to see the law on this subject as purely private. The provision protecting transferees therefore has a distinctly public orientation of protecting third-party interests and thus facilitating the aggregation of capital (if the law were otherwise, purchasers of shares would do so with a healthy respect for the chance that a hidden restriction deprives the transferee of the rights to ownership).

We therefore see there are many features of corporate law where the interests protected are by their nature beyond the scope of private ordering short of meaningful consent by the affected parties.[97] Modern limited liability company ("LLC") statutes stand in sharp contrast to the heavy public orientation of corporate statutes. As is well understood, the LLC is of fairly recent origin and founded on a desire to blend the favorable taxation feature of the partnership with the overarching corporate benefit of limited liability. The history of the LLC was shaped in the shadow of

96. *See generally* James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3 (1999) (reviewing how fiduciary obligations, and their enforcement, establish valuable social norms).

97. This point can be seen as reinforced by the express feature of corporate statutes authorizing in selected areas the approval of a majority of the shares to bind the minority. Absent express authority for the majority to act, the rights could not be affected. The once-rigid "vested rights" approach that froze all shareholders into a position supported by the minority was discarded early in the life of the corporation so as to facilitate commerce. But the authority of the majority to affect the interest of the minority is conditioned not only on there being clear authority to introduce the change, but importantly on the ex post inquiry into fair treatment, and in some instances the appraisal remedy supplanted the rigidity of contract as the means of protecting a disgruntled minority. *See* Coffee, *supra* note 11, at 1635.

the US Supreme Court's *Morrissey* tests for determining when an entity would not be deemed a corporation, thereby enabling it to enjoy non-taxpaying status.[98] Per *Morrissey,* the route for such a favorable revenue ruling was that the entity had more partnership than corporate features.[99] Since the common objective behind each such partnership feature was consent akin to that found in a contract, the LLC morphed along the lines of private ordering driven by consent of the LLC's members. Even though US tax authorities now embrace a more favorable "check-the-box" approach,[100] so that *Morrissey* today is a historic milepost, the legacy of the earlier treatment of LLCs remains: LLCs historically sought to avoid being a taxable entity by exuding private-ordering arrangements customary in partnerships. Thus, the hallmark of today's LLC statutes continues to be a full embrace of private ordering on a scale well beyond that found in general corporation statutes. For example, the Delaware Limited Liability Company Act provides: "It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[101] General corporate statutes, even in Delaware, lack any parallel to this provision.

The juxtaposition of LLC statutes with general corporation statutes not only invites but also confirms the conclusion that a clear distinction exists between the two with respect to the embrace of private ordering.[102] Whereas the LLC enjoys few private-ordering restrictions, corporate law provides a body of predictable mandatory rules and no open-ended invitation for their alteration. While less freedom for private ordering exists within the corporate statute, corporate statutes' greater rigidity through more standardized terms has social significance by reducing information costs for market participants as well as reducing legal

98. *See* Morrissey v. Comm'r, 296 U.S. 344, 354–59 (1935) (setting forth six factors to be considered in deciding whether an association is to be taxable as a corporation, such that an association that has more corporate than partnership attributes among the six factors would be a taxable entity).

99. *See id.*

100. In 1997, the US Internal Revenue Service replaced the *Morrissey* test by granting non-incorporated entities the freedom to elect whether to be treated for taxation purposes as a corporation or a partnership. 26 C.F.R. §§ 301.7701-1 to -3 (2015) (finalizing simplified entity classification rules).

101. DEL. CODE ANN. tit. 6, § 18-1101(b) (2015).

102. For the view that private ordering in LLCs is not the product of negotiations between promoters and investors and that the free-writing in delineating or eliminating fiduciary duties that commonly occurs within the operating agreement is a poor substitute for what can be accomplished within the corporate context, see Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11 (Robert W. Hillman & Mark J. Loewenstein eds., 2015).

uncertainty.[103] At a minimum, the distinction between the two bodies should caution against applying a contractual paradigm to corporate matters.

## IV. Lessons from the Principal-Agent Relationship

*Blasius Industries, Inc. v. Atlas Corp.*[104] bears significantly on the disconnection between the nexus-of-contracts paradigm and the corporation and shines a light on a core feature of corporate law: the division of authority between the board and the shareholders. Upon learning that a substantial blockholder was soliciting shareholders for their consent that would expand the board from seven to fifteen and thereupon appoint eight nominees to Atlas's board who would support a proposed restructuring of Atlas, the Atlas board moved swiftly to thwart a potential shift in control.[105] The Atlas board filled two of the board seats so that Blasius Industries could not quickly wrest control of Atlas.[106] Chancellor Allen, even though holding that the Atlas board acted in good faith in defending control, nonetheless held that the board's actions were beyond the protection of the business judgment rule.[107] He reached this conclusion by observing that the board's actions were not solely steps taken to manage the company, but instead were acts that impacted the relationship between principal and agent "with respect to a matter of internal corporate governance."[108] To so act, he believed the board needed to make a stronger case than merely that it had acted in good faith when its decision thwarted the shareholders' franchise. He therefore required the board to establish a compelling justification for interdicting the shareholder franchise to elect or nominate directors.[109] Significantly, the justification that must be advanced by the board is not a purpose narrowly focused on whether the *corporate interest* is advanced by management's unilateral interdiction; the compelling justification that is required must be anchored by how,

103. Coffee, *supra* note 11, at 1678.
104. 564 A.2d 651 (Del. Ch. 1988).
105. *Id.* at 654–55.
106. *Id.* Because the Atlas Board was classified, with directors serving staggered three-year terms, *id.* at 655, the consequence of filling two seats was that it would require two annual meetings for Blasius to have any chance to wrest a majority of the board seats.
107. *Id.* at 663.
108. *Id.* at 660.
109. *Id.* at 659–63.

under the circumstances, the board's action furthers the shareholders' franchise.[110] Allen reasoned:

> A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation. . . . Action designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and a shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not, in my opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment.[111]

To be noted as well is that *Blasius*' protection of shareholder franchise arises even though the board is acting in a way that is the exercise of corporate powers; a corporate purpose existed in *Blasius*—to continue the ongoing business plan—but a legitimate corporate purpose was not by itself sufficient to justify the board's actions that had the correlative effect of impacting the franchise of shareholders.[112] This observation flows from Chancellor Allen's holding that the board had acted consistently with its obligations to defend the corporation from a threatened change in the board's ongoing business policy.[113]

*Blasius* adheres to the wise advice that "agents whose interests may materially diverge from the interests of their principals should not have the power to unilaterally determine or materially vary the rules that govern those divergencies of interests."[114] That is, in the principal-agent realm, the

110. *See id.*
111. *Id.* at 660.
112. *Id.* at 658–63.
113. *Id.*
114. *E.g.*, Eisenberg, *supra* note 28, at 1474; *see also* Bebchuk, *supra* note 48, at 709–10 ("[I]t is necessary to constrain board-adopted election bylaws that opt out of the provided default arrangement to make it more difficult to replace incumbent directors."). Professor Bebchuk suggests a change in such a default rule be conditioned on the bylaw being approved by the shareholders. Bebchuk, *supra* note 48, at 709–11. He offers as support that the Delaware legislature has set the model for this approach by permitting the bylaws adopted after shares have been issued to classify the board only if the bylaw has been approved by the shareholders. *Id.* at 710; *see also* DEL. CODE ANN. tit. 8, § 141(d) (2015). A higher level of approval is also required to provide directors immunity from damages, where such a shield must appear in the articles of incorporation so that the shield, if adopted after shares have

relationship and the methods for selecting and controlling the agent are defined by the principal and not the agent. To this end, and as *Blasius* illustrates, managerial actions that impact the owners' ability to pursue the limited powers owners have to discipline managers—sell, suffrage, or sue—are not just of a different order of magnitude; they are within an entirely different sphere of corporate law, that of governance. Because they are not within the board's managerial sphere, they are to be judged by a very different standard than applies to questions of management's stewardship of the firm's business. This conclusion, as well as *Blasius*' holding, flows naturally from the fact that corporate statutes, while broadly enabling of the board of directors, nonetheless restrict the board's powers to matters of the corporation and to the limited areas of the shareholders' franchise. Under today's statutes, the board's—and hence its appointees'—authority with respect to the firm's operations is clearly set forth in the command that "all *corporate* powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of *the corporation* shall be managed by or under the direction" of the board of directors.[115] Simply stated, a general grant of authority to the board of directors to adopt, amend, and repeal bylaws is a weak basis for concluding such authority extends to altering the rights or protections shareholders customarily enjoy.

Because corporate statutes typically impose no limit on the content of bylaws except that a bylaw not conflict with the corporate statute or the company's charter, the content of bylaws is open ended.[116] Therefore, bylaws typically and appropriately address a wide range of matters, from internal operations (e.g., description of authority of officers) to functioning of the board (e.g., notice and quorum for meetings) to shareholder-related matters such as notice and procedures for meetings. The board unquestionably has authority to act in these areas, but its authority is not the same across all areas. The thesis of this Article is that the board's authority to act within areas peculiar to the shareholder franchise cannot

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been issued, requires amendment with the approval of the stockholders. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015).

115. MODEL BUS. CORP. ACT § 8.01(b) (2007) (emphasis added); *see also* DEL. CODE ANN. tit. 8, § 141(a) (2015) (emphasis added) ("The business and affairs *of every corporation* . . . shall be managed by or under the direction of a board of directors.").

116. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(b) (2015) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."); N.Y. BUS. CORP. LAW § 601(b) (McKinney 2015); MODEL BUS. CORP. ACT § 2.06(b) (2007).

be premised on its authority to act on contract. In proceeding on the basis that the shareholders' relationship is contractual and therefore amenable to unilateral change, the courts have failed to mediate the conflicting interests and allied rights that distinguish owners from managers. Therefore, the nexus-of-contracts notion that the board has wide-ranging authority to alter the shareholder relation to the board therefore is not only at odds with *Blasius* but also ignores the distinctions corporate law makes with respect to institutional prerogatives of the board and those of the shareholders, and, more fundamentally, why they are not mirror images of one another. Each has a sphere of authority and a related sphere of protection from the other's encroachment.[117]

There is an even stronger and broader message behind *Blasius*: there needs to be recognized among corporate law certain mandatory prophylactic rules whose existence and enforcement are understood as necessary to prevent opportunistic insider behavior. And this bundle of rules is beyond private ordering except pursuant to the most scrupulous attention to consent's being granted. As in *Blasius*, an escape from such rules' protections or requirements must be zealously protected, perhaps by the "compelling justification" standard invoked by Chancellor Allen.[118] Minimally, there should be a strong presumption that the rules establish a sacred space for shareholders that can rarely be entered by the board.

## V. FINDING THE SHAREHOLDERS' FRANCHISE

*Blasius* and the provisions in corporate statutes that bestow authority on the board support an approach toward defining the board's authority that recognizes that the authority, and hence deference the board enjoys with respect to stewardship of the corporation's business, do not apply to all areas in which the board as a technical matter has the power to act. As developed in this section, the state corporate statutes illuminate areas

117. Just as *Blasius* protected the shareholder franchise, Delaware recently acted to protect the board's rights from the shareholders. *See* Gorman v. Salamone, C.A. No. 10183-VCN, 2015 WL 4719681, at *4–6 (Del. Ch. July 31, 2015) (invalidating shareholder-adopted bylaw that empowered shareholders to remove company officers).

118. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988). Unfortunately, the Delaware courts have cabined *Blasius* to the shareholders' right to vote. Moreover, the Delaware Supreme Court has weakened the opinion by lamenting its demanding standard. Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) ("*Blasius*' burden of demonstrating 'compelling justification' is quite onerous, and . . . therefore [should be] applied rarely."). It is also observed that the Delaware courts do not consider, as logic would suggest, demanding that the board explain its conduct thwarting shareholder action when, as in *Blasius*, the circumstances support the conclusion that the board could have sought shareholder approval for its actions.

where there should be no less than a rebuttable presumption that the board lacks authority to act.

The board as a general matter has authority to amend the bylaws, but it is a power divined within the richer environment of principles and tenets of corporate law. Chancellor Allen isolated one such tenet: the shareholder franchise to elect and hence nominate directors.[119] It would seem a small step, but of immense effect, to extend this franchise more generally to the right of shareholders to vote. To be sure, corporate statutes condition consummation of certain transactions as well as each individual director's membership on the board's being elected by the shareholders. Moreover, the shareholders' authority to adopt bylaws empowers shareholders with authority to act on matters of process germane to their authority to so vote, and presumably to vote on matters otherwise linked to rights they enjoy, thereby extending the scope of their franchise.[120] Post-*Blasius* decisions have therefore recognized shareholder voting as such a protectable right.[121]

A further area of shareholders' rights is the right to information bearing on the corporation's financial position and performance as well as information germane to their status as shareholders. While only about one-half of the states require that financial information on the firm be periodically provided to the shareholders,[122] as a matter of common law, supplemented by statutory provisions, shareholders have reasonable information rights that enable access to the records in the company's possession.[123] Even though such access is conditioned on the shareholder having a proper purpose, access to information in the corporation's possession is unquestionably among the items within the shareholders' franchise.

Another important shareholder franchise is the shareholder's right to sell her shares. This area of corporate law provides important lessons on the franchise's protection, as well as the limited instances in which the

119. *Blasius*, 564 A.2d at 660–61.

120. *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 240 (Del. 2008) (upholding the shareholder-initiated bylaw authorizing the reimbursement of proxy contest expenses in non-control situations, albeit holding that the particular bylaw failed to limit such reimbursement to instances not in conflict with the board's fiduciary obligations).

121. *See, e.g.*, MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1131 (Del. 2003) (using the *Blasius* compelling justification standard to evaluate the defensive actions that prevented shareholders from being able to elect a successor director). Delaware has nonetheless restricted *Blasius* to voting contexts. *See Williams*, 671 A.2d at 1376 (holding that *Blasius* applies only when shareholders are not given a full and fair chance to vote); Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 330–31 (Del. Ch. 2010) (holding that *Blasius* was not implicated by a provision that had the effect of preventing a single holder from accumulating more than 20 percent of the stock).

122. *See* MODEL BUS. CORP. ACT ANN. § 16.20 (4th ed. 2013).

123. *See* 3 COX & HAZEN, *supra* note 29, § 13.3.

legislature has employed the contractual paradigm in the corporate law. The twin considerations of the early common law's strong embrace of the free alienability of property[124] and the belief that the ability to exit an investment is one of the few options available to an unhappy minority holder[125] led courts to view share-transfer restrictions skeptically. Nonetheless, restrictions on transfer are justified by a number of reasonable considerations that serve the interests of the corporation and/or its owners. Consider the insight of Chief Justice Oliver Wendell Holmes: "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. . . . [T]here seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm."[126]

Today, the corporate statutory provisions broadly accord validity to share-transfer restrictions, albeit with all the features of the law of contracts.[127] For example, a line of cases holds that even though a bylaw imposing a stock-transfer restriction may be invalid, the restriction is nonetheless enforceable as a contract if consent and consideration exist.[128] A far more important effect of the contract-oriented approach is that it removes from consideration the particular terms of the transfer restriction in assessing the reasonableness and hence validity of the particular restriction. Thus, a restriction consented to such that a contract can be found is not unreasonable and hence not invalid on the ground it deprives the transferring shareholder of a "fair price."

The most significant contract law feature of the regulation of share-transfer restrictions is the necessity of consent for a restriction to apply to a holder's shares. State law commonly provides that a restriction introduced after shares have been issued does not apply to shares unless the shares were voted in favor of the restriction.[129] *Sandor Petroleum*

124. 17 WILLISTON, *supra* note 67, § 51.64.

125. *See* 3 COX & HAZEN, *supra* note 29, § 14.9. The fact that we rarely find share transfer restrictions in non-close corporastions, see generally David I. Walker, *Rethinking Rights of First Refusal*, 5 STAN. J.L. BUS. & FIN. 1, 11 (1999), reflects the high premium non-close-corporation owners place on the liquidity of their ownership interest.

126. Barrett v. King, 63 N.E. 934, 935 (Mass. 1902).

127. *See, e.g.*, Coury v. Moss, 529 F.3d 579, 585 (5th Cir. 2008).

128. B & H Warehouse, Inc. v. Atlas Van Lines, Inc., 490 F.2d 818, 822–23 (5th Cir. 1974) (citing Palmer v. Chamberlin, 191 F.2d 532 (5th Cir. 1951); Nicholson v. Franklin Brewing Co., 91 N.E. 991 (Ohio 1910)).

129. *See, e.g.*, DEL. CODE ANN. tit. 8, § 202(b) (2015) ("No restrictions so imposed shall be binding with respect to securities issued prior to the adoption of the restriction unless the holders of the securities are parties to an agreement or voted in favor of the restriction."); MODEL BUS. CORP. ACT § 6.27(a) (2007) ("A restriction does not affect shares issued before the restriction was adopted unless the holders of the shares are parties to the restriction agreement or voted in favor of the restriction.").

*Corp. v. Williams*[130] is illustrative of the common law that the board of directors cannot adopt a bylaw that conditions any sale on first providing the corporation with the option to purchase the shares at a price determined by an arbitrator.[131] The court reached this result even though the state statute authorized reasonable transfer restrictions to be imposed through the bylaws and authorized the board to amend company bylaws.[132] While broadly framing the issue within the strong public policy favoring the free alienation of property that as a general proposition qualifies the broad grant of authority to the board, the court, similar to the reasoning above, observed that the board's authority with respect to its powers, including the exercise of its statutory authority to amend the bylaws, was limited to matters germane to the corporation's operations and not the affairs of the stockholders.[133]

The prevailing view that transfer restrictions cannot be imposed on a non-consenting shareholder underscores that, absent express statutory authority to the contrary, individually held shareholder rights cannot be changed with respect to the individual shareholder without that shareholder's consent.

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A notable outlier in the common law on this issue is provided by the California Supreme Court in *Tu-Vu Drive-In Corp. v. Ashkins*, 391 P.2d 828, 830 (Cal. 1964), holding that an amendment to the articles of incorporation or bylaws adopted by majority vote could impose a transfer restriction on shares of non-consenting shareholders. *Id.* The court viewed share-transfer restrictions no differently than so many activities and transactions within the corporate setting where decisions impacting all owners are by majority vote. *Id.* Contemporary criticism of *Tu-Vu Drive-In* emphasizes the opinion's inattention to the restriction's adverse impact on the value of the shares, even in the relatively benign setting in *Tu-Vu Drive-In* where the overall effect of the bylaw was to prolong the sale process so that the corporation could exercise its option to purchase the shares at the same price as offered by the third-party purchaser. John K. McNulty, *Corporations and the Intertemporal Conflict of Laws*, 55 CALIF. L. REV. 12, 27 (1967). *Tu-Vu Drive-In* remains an aberration and indeed has since been overruled by the legislature, see CAL. CORP. CODE § 204(b) (West 2015), so that California is now aligned with all other states in justifying share restrictions on the overarching principle of contract law: only consenting parties are bound by a contract. *See* 1 WILLISTON, *supra* note 67, § 1.3. The prevalent position in American corporate law is that the strong public policy favoring the transferability of shares conditions the restriction on consent. With the consent-contract orientation, the reasonableness of a restriction's terms is removed from considering whether the restriction is enforceable. *See B & H Warehouse*, 490 F.2d at 826 (distinguishing *Tu-Vu Drive-In* on grounds that restriction upheld there required fair value be paid for shares, so its impact was solely to identify to whom the shares would be sold, whereas the restriction in the principal case required shares be sold at a book value that was substantially below the fair market value, so that restriction in its application was not deemed to be reasonable).

130. 321 S.W.2d 614 (Tex. Ct. App. 1959).

131. *Id.* at 616–17.

132. *Id.* at 618.

133. *Id.* at 619.

The weight of corporate authority with respect to the necessity of stockholder consent for transfer restrictions conflicts with *Boilermakers*' approach that the bylaws are themselves a contract whose amendment, even unilaterally by the board of directors, binds all shareholders.[134] Contrast *Boilermakers*' approach with that in *Joseph E. Seagram & Sons, Inc. v. Conoco, Inc.*[135] Striking down a share restriction sought to be imposed on a non-consenting shareholder, the court reasoned that not to require consent would "produce the incongruous result of allowing the Board of Directors unilaterally to impose stock transfer restrictions . . . . [T]he Legislature could not reasonably have intended to produce such onerous results."[136] This statement contrasts sharply with the board's unilateral action approved in both *Boilermakers* and *ATP Tour*. Just as the shareholder franchise includes her power to sell shares, so it extends to the power to sue for misconduct by corporate fiduciaries. Thus, of those components of the shareholder's franchise must be protected such that unilateral action by the board of directors that intrudes on this space must be jealously regarded. It was in *Joseph E. Seagram & Sons* but was not in *Boilermakers* and *ATP Tour.*

## VI. CONCLUSION—THE PATH FORWARD

It is not likely that shareholder rights can be ranked into a defensible hierarchy where one set of rights, the right to sell shares, can be affected only pursuant to express statutory authority, while another set of rights, the right to nominate and vote for directors, is conditioned on some high fiduciary standard, for example a compelling justification, and all other rights are examined ex post for their fairness. Not only does it seem unreasonable to accord rights varying orders of importance, but to do so ignores the important impact of circumstances that invariably change from situation to situation. To be sure, fiduciary duty law, as observed earlier, derives its vitality from ex post consideration in the context of factually rich circumstances. But the point developed here is that the issue is not whether a wrong has been committed, but whether the board had the power to act. Clothing important organic questions such as those raised in *Boilermakers* and *ATP Tour* as a fiduciary inquiry ignores the structure of corporate law. To be sure, fiduciary duties apply to the exercise of powers enjoyed by the board. But the first question is whether the board had the

134. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 939–41 (Del. Ch. 2013).
135. 519 F. Supp. 506 (D. Del. 1981).
136. *Id.* at 513–14.

authority to act on that matter. Both *Boilermakers* and *ATP Tour* understood this to be the question, but answered it incorrectly as being contractually decided, when in fact there was no contract and could not be such a contract. Corporations act through contracts, but they are not contracts.

Thus, the board enjoys a strong and well-justified presumption of propriety with respect to matters within its charge: managing and overseeing the management of the corporation's affairs.[137] The shareholders' rights are limited. They can be found in various places in the corporate statute. Statutes contemplate that shareholders can initiate derivative suits. Law recognizes that when one is harmed by another in tort, suit for redress exists. These are rights of the shareholder, and there should be no less than a strong presumption that the board of directors lacks the authority to affect those rights unless expressly authorized by the prevailing corporate statute. Even where so authorized, an informed legislature should ask why it is that the board alone should have the power to act when impacting a right historically enjoyed by the shareholders. Much like a bylaw that classifies the board of directors of a Delaware corporation (which in Delaware requires shareholder approval),[138] public policy should at a minimum condition the change on shareholder approval. The Author supports most forms of forum-selection bylaws. Because forum-selection bylaws can be seen as a sensible solution to multi-forum litigation, there is every reason to believe shareholders would approve such bylaws.[139] Therefore, the need for unilateral action that can cast doubt on the directors' fidelity to the shareholders appears weak.

Regardless of the better approach for instituting an antidote for multi-forum litigation, this Article calls for courts to divert course from the deceptive nature of the nexus-of-contracts approach and return to the corporate statute to divine the relative rights of the board vis-à-vis the

137. Correlative to the position developed in this Article is the decision in Gorman v. Salamone, C.A. No. 10183-VCN, 2015 WL 4719681 (Del. Ch. July 31, 2015) (invalidating removal of the CEO pursuant to a bylaw recently adopted by the majority holder empowering shareholders to remove officers upon a majority vote). Just as the majority shareholder in *Gorman* could not prevail on the argument that he had broad power to amend bylaws to invade the prerogatives of the board to fire officers, so it is that the board's encroachment on the shareholders' franchise should be protected from assaults in the case of contracting through broadly-drafted grants of authority to amend the bylaws.

138. DEL. CODE ANN. tit. 8, § 141(d) (2015).

139. Although a sensible solution, forum-selection bylaws adopted unilaterally by the board of directors do not address the fundamental question raised in this Article; namely, the board's power to act unilaterially on this topic. Because forum-selection bylaws are sensible, there is no reason for the board not to present a forum-selection bylaw for the shareholders' approval. Indeed, the infinite sensibility of the solution to the problem erodes the case for the board to act preemptively.

shareholders. By casting aside the agenda that comes with the metaphor, authority to act can be better placed in the corporate statute, where the rights of owners can be found. Where those rights exist, just as they were found in *Blasius*, the board lacks the authority to act alone.