

Contents

Preface	xix
Chapter 1 • Introduction and Formation	3
§ 1.01 Introduction	3
§ 1.02 Sources of Corporate Law	6
§ 1.03 Historical Background	7
§ 1.04 Choice of Form	8
[A] Sole Proprietorship	8
[B] Partnership vs. Corporation	9
§ 1.05 Limited Partnerships	12
§ 1.06 Limited Liability Company	13
§ 1.07 Taxation	13
[A] Double Taxation	14
[1] Subchapter S Corporation	15
[2] Limited Liability Companies	15
§ 1.08 Incorporation and Organization	16
§ 1.09 Choice of Law	17
[A] Delaware's Dominance	18
§ 1.10 Ultra Vires	20
[A] Corporate Social Responsibility and Philanthropy	21
§ 1.11 Social Benefit Organizations	22
Chapter 2 • Promoters' Liability and Defective Incorporation	25
§ 2.01 Introduction	25
§ 2.02 Promoters' Liability on Preincorporation Contracts	25
[A] Overview	25
[B] Liability of the Promoter	26
[C] The Strict View of Promoters' Liability	27
[D] Reliance on the Intent of the Parties	27
[E] Liability of the Newly Formed Corporation or LLC	29
[F] Promoters' Fiduciary Duties	31
§ 2.03 Defective Incorporation	32
[A] The Problem	32
[B] The De Facto Corporation Doctrine and Corporation by Estoppel	33
[C] Statutory Abolition of the De Facto Corporation Doctrine	34
[D] Does Corporation by Estoppel Survive the Model Business Corporation Act?	35
[E] Model Business Corporation Act Compromise	36
[F] Corporate Death	36

Chapter 3 • Piercing the Corporate Veil	37
§ 3.01 The Concept of Limited Liability	37
§ 3.02 The Limited Liability Debate	39
§ 3.03 Grounds for Piercing the Corporate Veil	41
[A] Introduction	41
[B] Intermixture of Affairs	42
[C] Lack of Corporate Formalities	43
[D] Veil Piercing in Limited Liability Companies (LLCs)	44
[E] Inadequate Capitalization	45
[1] Overview	45
[2] What Is Capital for These Purposes?	45
[3] When Is Capital Adequate?	46
[4] Is Inadequate Capitalization Alone a Sufficient Ground?	46
[5] Does a Duty Ever Arise to “Top Off” the Original Capital?	48
[F] Evasion of a Contract or Statute or Use of a Corporation Solely to Work a Fraud	49
[G] Instrumentality Theories	50
[H] Torts Versus Contracts	51
§ 3.04 Equitable Subordination	52
§ 3.05 Piercing the Corporate Veil: Procedural Contexts	54
§ 3.06 Statutory Liability Under Environmental Laws	55
§ 3.07 Successor Corporation Liability in Products Liability	56
§ 3.08 Piercing the Corporate Veil—Structural Settings	57
[A] Personal Shareholder Liability	57
[B] Parent-Subsidiary Settings	59
[C] Brother-Sister (Sibling) Corporation Settings	61
[D] Enterprise Liability	64
[E] Reverse Piercing	65
[F] Participation	66
[G] Summary	67
 Chapter 4 • Financing the Corporation	 69
§ 4.01 Introduction	69
§ 4.02 Securities	70
[A] Debt	70
[B] Common Shares	71
[C] Preferred Shares	72
§ 4.03 Leveraging and Capital Structure	73
§ 4.04 Legal Capital Rules	74
[A] Preemptive Rights	75
[B] Par Value	75
[C] Dividends and Repurchases of Shares	76
§ 4.05 Valuation	78
[A] Liquidation Value	78
[B] Book Value	79
[1] Cost Based Accounting	79
[2] Depreciation	80
[3] Intangible Assets	80
[C] Earnings Approach	81

[1] Capitalization of Earnings	82
[2] Cash Flow as Earnings	82
[3] The Rate	83
Chapter 5 • The Legal Model and Corporate Governance: Themes and the Allocation of Power Under State Law	85
§ 5.01 Introduction	85
§ 5.02 Themes	86
[A] Focus of Corporate Governance and Stakeholders	87
[B] Publicly Held Corporation	90
[C] The Stock Markets	91
[1] Benefits of Stock Markets	92
[2] Shareholder Protection and Stock Markets	93
[D] The Efficient Capital Market Hypothesis	94
[E] Role of Ownership	96
[1] The Berle-Means Corporation — Separation of Ownership from Control	96
[2] Institutional Investors	97
[3] Political Significance of Share Ownership	99
[F] Independent Directors	100
[G] Gatekeepers	102
[H] Federalism	103
[I] Publicly Held vs. Closely Held Corporations	104
§ 5.03 Theories of the Firm	105
[A] Regulatory Approach	105
[B] Management, Director, or Shareholder Approach	106
[C] Law and Economics Approach	107
[1] Agency Costs	107
[2] Markets	107
[3] Nexus of Contracts	108
[4] Critics of Contractual Approach	109
[5] Behavioral Economics	109
§ 5.04 The Legal Model	110
§ 5.05 Shareholders	111
[A] Right to Vote	111
[1] Cumulative Voting	113
[2] Right of Expression	115
[B] Shareholder Meetings and Proxy Voting	115
[C] The Proxy Fight	117
[1] Change or Influence Management	118
[2] Replace Directors to Facilitate an Acquisition	118
[3] Change Policy	119
[a] Shareholder Proposals	119
[b] Withholding Votes	121
[c] Nominating Directors in Management's Proxy Statement	121
[4] Collective Action Problem	122
[5] Proxy Expenses	123
[D] Shareholder Democracy	124
[1] Fiduciary Duty	124

[E] Vote Buying	128
[F] Right to Information	129
§ 5.06 Board of Directors	132
[A] Board Structure	132
[B] Meetings	133
[1] Actions Without a Meeting	133
§ 5.07 Officers	135
[A] Authority	135
§ 5.08 Financial Scandals	137
[A] The Sarbanes-Oxley Act of 2002	137
[B] Dodd-Frank Act of 2010	142
 Chapter 6 • Mergers and Acquisitions	 145
§ 6.01 Introduction	145
§ 6.02 Mergers	145
[A] Triangular Merger	147
[B] Reverse Triangular Merger	148
[C] Short Form Merger	149
§ 6.03 Sale of Assets	149
§ 6.04 Tender Offer	150
§ 6.05 Other Legal Issues	152
§ 6.06 Appraisal Remedy	152
[A] Delaware Block Approach	154
[1] The New Delaware Methodology	156
[B] Stock Market Exception	158
§ 6.07 De Facto Mergers	159
 Chapter 7 • Introduction to Federal Regulation and the Proxy Rules	 161
§ 7.01 Introduction and Overview	161
§ 7.02 SEC Jurisdiction and Periodic Reporting by Publicly Held Corporations	163
[A] SEC Jurisdiction	163
[B] Periodic Reporting—An Overview	165
[C] Certifications, Code of Ethics Disclosure, and Penalties for Earnings Restatements	166
[D] Private Securities Litigation Reform Act (PSLRA) Safe Harbor for Forward Looking Statements	167
[E] Management Discussion and Analysis (MD&A)	167
[F] Earnings Management and Revenue Recognition Issues	168
§ 7.03 Securities Issuance	169
[A] The Federal Disclosure Philosophy	169
[B] Registration Requirements	170
[C] The Registration Process	172
[D] Exemptions From Registration	175
[1] Scope	175
[2] The Intrastate Exemption	175
[3] The Private Offering Exemption	175
[4] Regulation D Exemptions	177
[5] Crowdfunding	178

§ 7.04 Proxy Regulation	179
[A] Introduction	179
[B] A Proxy Solicitation Hypothetical	180
[C] Proxy Contests	182
[1] The Shareholder's Role	182
[2] Inadvertent Solicitation and Other Problems	182
[3] Regulatory Burdens and Costs	184
[4] Proxy Contest Procedures and Further Costs	184
[D] Use of Shareholder Consents	186
[E] The Internet and the "Notice and Access" Proxy Regime	186
§ 7.05 The SEC Shareholder Proxy Proposal Rule: SEC Rule 14a-8	187
[A] Proposals	187
[B] Eligibility and Procedure	189
[C] Background on the Nature of the Proposals	190
[D] Mechanics of the Shareholder Proxy Proposal Process	191
[E] The 14a-8, Question 9(7), Ordinary Business Operations Exclusion	193
[F] Other Rule 14a-8 Exclusions	197
[G] Proposals to Amend Corporate Bylaws	198
[H] <i>CA, Inc. v. AFSCME Employees Pension Trust</i>	199
§ 7.06 The Proxy Rules' General Antifraud Rule: An Introduction to	
General Disclosure Law Concepts	201
[A] Introduction	201
[B] SEC Rule 14a-9	202
[C] Implication of Private Rights of Action	204
[D] Standing to Sue	206
[E] Materiality of the Omission of the Misleading Statement	207
[F] State of Mind (Fault) Required	208
[G] Causation	210
[H] Remedies	213
Chapter 8 • Introduction to Fiduciary Duty: The Duty of Care, the	
Business Judgment Rule and Good Faith	215
§ 8.01 Introduction	215
[A] Overview of Duty of Care and Loyalty	216
[B] Sliding Scale	217
§ 8.02 Policy Issues	218
[A] Law and Economics Approach	219
§ 8.03 Duty of Care	220
[A] Nonfeasance	222
[B] Malfeasance and the Business Judgment Rule	223
[C] Causation	225
§ 8.04 The <i>Smith v. Van Gorkom</i> Case	227
§ 8.05 The Demise of the Duty of Care	229
[A] Delaware General Corporation Law § 102(b)(7)	230
§ 8.06 Good Faith	232
[A] <i>Disney</i> Litigation and Good Faith	232
[B] The Duty to Monitor and <i>Stone v. Ritter</i>	233
§ 8.07 Duty of Disclosure	237
§ 8.08 Duty to Act Lawfully	239

Chapter 9 • The Duty of Loyalty and Conflicts of Interest	241
§ 9.01 Introduction	241
§ 9.02 Policy	242
§ 9.03 Interested Director Transactions	243
[A] Common Law	246
[B] Statutory Responses	247
[1] Weak Form Approach	249
[2] Semi-Strong Approach	250
[a] The New York Approach	251
[b] The Current California Approach	251
[3] Strong Form Approach	251
[a] Delaware Approach	251
[b] The MBCA Approach	253
§ 9.04 Executive Compensation	254
[A] Stock Options	258
[B] Good Faith and Compensation	260
[C] Waste	263
[1] Delaware's Waste Standard	263
§ 9.05 Corporate Opportunity and Abuse of Position	265
[A] Legal Tests	266
[1] Interest Test	266
[2] Line of Business Test	267
[3] Fairness Test	268
[4] The ALI Test	268
[B] Financial Inability	270
[C] Multiple Boards	271
[D] Use of Information and Competition	271
[E] Undisclosed Profits	272
§ 9.06 Shareholder Voting—Ratification and Optional Voting	273
[A] Effect of Optional Disinterested Shareholder Voting	274
 Chapter 10 • Controlling Shareholders	 277
§ 10.01 Introduction	277
§ 10.02 Use of Control	279
[A] The <i>Zahn</i> Case	279
[B] Parent-Subsidiary Dealings	281
[C] Sale of Corporation	282
§ 10.03 Freezeouts	283
[A] Policy Issues	284
[B] State Law	287
[C] Cases	289
[1] The <i>Weinberger</i> Case	289
[2] Post- <i>Weinberger</i> Cases	291
[a] Appraisal versus Equity in Delaware	292
[b] Fair Dealing	293
[i] Negotiating Committee of Independent Directors	294
[ii] Majority of Minority Shareholder Voting	296
[iii] Both Independent Board and Shareholder Approval	297
[c] Business Purpose	298

[d] The Controlling Shareholder's Tender Offer	298
[D] Federal Law	300
[1] SEC Rule 13e-3	300
[2] SEC Rule 10b-5	301
§ 10.04 Sale of Control	303
[A] Looting	306
[B] The <i>Perlman</i> Case	307
[C] The California Approach	308
[D] Sale of Office	310
Chapter 11 • Special Problems of the Closely Held Corporation	313
§ 11.01 Introduction and Overview	313
[A] Definitions of a Close Corporation	313
[B] Illiquidity and Exploitation	314
[C] Corporate Law Responses to the Illiquidity and Exploitation Situation	315
§ 11.02 Obtaining and Maintaining a Measure of Control	316
[A] Preview	316
[B] Shareholder Voting Agreements	317
[C] Irrevocable Proxies	318
[D] Voting Trusts	320
[E] Class Voting	323
[F] Cumulative Voting	324
[G] Summary	324
§ 11.03 Protecting Shareholder Expectations in Closely Held Corporations	325
<i>Ex Ante</i>	325
[A] Contract	325
[B] Long-Term Shareholder Tenure and Salary Agreements	325
[C] Less Than Unanimous Shareholder Agreements	327
[D] Other Agreements Affecting Directors' Discretion	328
[E] Comprehensive Shareholder Agreements	330
§ 11.04 Restrictions on Share Transferability	331
[A] Introduction	331
[B] Umbrella Test — Unreasonable Restraint Upon Alienation?	332
[C] Other Legal Aspects of Share Transfer Restrictions	334
[1] Legal Capital and Funding	334
[2] Procedural Aspects	335
[3] Disparity Between Buy-Out Price or Formula and Fair Price	335
[4] Implied Covenant of Good Faith and Fair Dealing	336
[5] Notice	337
§ 11.05 Other Governance Features of the Closely Held Corporation	338
[A] Overview	338
[B] Greater Than Majority Quorum and Voting Requirements	338
[C] Informal Action by Shareholders and Directors	340
§ 11.06 Close Corporation Statutes	340
§ 11.07 Protecting Shareholder Expectations in the Close Corporation	341
<i>Ex Post</i>	341
[A] Resetting the Problem	341
[B] Heightened Fiduciary Duty in the Close Corporation Setting	342

[C] Heightened Fiduciary Duty in Other Jurisdictions	346
[D] Two Worlds Collide: The <i>Donahue</i> Principle Meets Employment at Will	346
[E] Involuntary Dissolution Statutes	348
[F] Cases of Deadlock	349
[G] Oppression Grounds	351
[H] Remedies in Involuntary Dissolution Cases	354
[I] Valuation Issues in Court Ordered Buyouts	357
[J] Conclusion	358
§ 11.08 Limited Liability Companies	358
[A] Introduction	358
[1] Hybrid Nature	358
[2] Manager-Managed	359
[3] Comparison with Limited Partnership	359
[4] Comparison with the Limited Partnership Hybrid	359
[B] Background	360
[C] Formation of an LLC	361
[D] Finance	362
[E] Veil Piercing in LLCs	362
[F] Authority of Members and Managers	363
[G] Fiduciary Duties of LLC Managers and Members	364
[1] Introduction	364
[2] Implied Covenant of Good Faith and Fair Dealing	364
[3] The Duty of Loyalty	364
[4] Competition with the LLC	366
[5] Opting out of Fiduciary Duties	366
[6] Exculpatory Provisions	367
[H] Dissolution of an LLC	367
[I] Limited Liability Partnerships	369
[J] Series	371
[K] Social Enterprises, Mission Driven Companies, and the Low Profit Limited Liability Company (L3C)	371
Chapter 12 • Hostile Tender Offers	373
§ 12.01 Introduction	373
§ 12.02 The Rise and Fall of Hostile Tender Offers	374
§ 12.03 Policy Issues	376
[A] Proponents	376
[B] Opponents	377
§ 12.04 Tactics	379
[A] Bidder Tactics	379
[B] Target Tactics	381
[1] Poison Pills	383
§ 12.05 State Law	387
[A] Delaware Approach	389
[1] The <i>Cheff</i> Case	389
[2] The <i>Unocal</i> Test	389
[3] The <i>Revlon</i> Test	391

[4] The <i>Time</i> Case	393
[5] The QVC Case	395
[6] The <i>Unitrin</i> Case	397
[7] Shareholder Voting and Tender Offers	399
[8] Judicial Scrutiny of Deal Protection	400
[a] The <i>Omnicare</i> Case (Using <i>Unocal</i>)	401
[b] The <i>Lyondell</i> Case (Using <i>Revlon</i>)	403
[9] Summary	404
§ 12.06 Federal Securities Law—The Williams Act	407
[A] History	407
[B] Disclosure Rules	408
[C] Other Rules	409
[D] Section 14(e)	409
§ 12.07 State Takeover Statutes	410
[A] Introduction	410
[B] Policy Issues	411
[C] Constitutionality	413
[1] The <i>Edgar</i> Case	413
[2] The <i>CTS</i> Case	414
Chapter 13 • SEC Rule 10b-5 Disclosure and Insider Trading	417
§ 13.01 SEC Rule 10b-5 Disclosure and Insider Trading	417
§ 13.02 Disclosure Concepts and Elements of a Cause of Action Under Rule 10b-5	420
[A] Implication of Private Rights of Action	420
[B] Standing to Sue	420
[C] Materiality	422
[D] State of Mind	425
[E] Pleading State of Mind	427
[F] Reliance (Transaction Causation)	429
[G] The Fraud on the Market Theory Reliance Substitute	431
[H] Loss Causation	433
[I] The “In Connection With” Requirement	434
[J] Privity	435
[K] Secondary Liability for Disclosure Violations	435
[L] Statutes of Limitation	438
§ 13.03 The Prohibition of Insider Trading: Is It Good or Bad?	438
§ 13.04 The Law of Insider Trading	441
[A] Common Law Background	441
[B] The Nature of the Insider Trading Prohibition	442
[C] Who Is an Insider?	443
[D] Tipper-Tippee Liability	445
[E] The Misappropriation Theory	448
[F] The Misappropriation Theory in the Supreme Court	450
[G] Tippees of Misappropriators	453
[H] Remedies and Enforcement	454
[I] SEC Regulation FD	456
§ 13.05 The Insider Trading Prohibition Under State Law	457
[A] Common Law	457

[B] Common Law Exceptions: The Kansas Rule	458
[C] Common Law Exceptions: Special Facts Doctrine	458
[D] Modern Expansion of the Special Facts Doctrine	459
[E] Finding Harm to the Corporation from the Insider's Trading	459
§ 13.06 Regulation of Insider Trading Under Section 16 of the Securities Exchange Act of 1934	460
[A] Statutory Provisions	460
[B] Parties Plaintiff and Calculation of Damages	461
[C] Who Is an Officer for Section 16 Purposes?	463
[D] Insider Status at Only One End of a Swing	463
[E] Takeover Players and Section 16(b)	464
Chapter 14 • Corporate Litigation	465
§ 14.01 Introduction	465
§ 14.02 The Nature of the Derivative Suit: Direct Versus Derivative, Pro Rata Recovery, and Other Preliminary Issues	467
[A] The Nature of the Derivative Suit	467
[B] Direct Versus Derivative—Special or Distinct Injury Rule	468
[C] Direct Versus Derivative—Denial of Contract Rights Associated With Shareholding	471
[D] Direct Versus Derivative—Closely Held Corporation Exception	472
[E] Pro Rata (Individual) Recovery in Derivative Actions	473
[F] The <i>Tooley</i> Test in Delaware	476
§ 14.03 Qualifications of a Proper Plaintiff-Shareholder	477
[A] Record Ownership	477
[B] Contemporaneous Ownership	477
[1] Introduction	477
[2] Basis for the Rule	478
[3] Possible Exception: Undisclosed Wrongdoing	479
[4] Exception: Continuing Wrong	479
[5] Exception: Double Derivative Actions	480
[C] Continuous Owner	481
[D] Clean Hands Requirement	482
[E] Adequate Representation Requirement	482
[F] Selection of Lead Counsel	484
§ 14.04 Reforms of the Earlier Strike Suit Era	485
[A] Overview	485
[B] Verification Requirement	485
[C] Security for Expenses Requirements	486
§ 14.05 The Demand Rule	487
[A] Overview	487
[B] Demand Refused	488
[C] Demand Accepted	489
[D] Demand Excused	490
[1] Introduction	490
[2] The Futility Exception	490
[a] Introduction	490
[b] Legal Tests for Demand Futility	491
[c] Disabling Conflicts of Interest	492

[d] Lack of Independence	493
[3] Threat of Irreparable Harm	495
[4] Closely Held Corporations	495
[5] Delay	495
[6] Neutrality	496
[E] Demand on Shareholders	496
§ 14.06 Termination of Litigation: The Advent of the Special Litigation Committee Device	497
[A] Background	497
[B] Application of the Business Judgment Rule	498
[C] Delaware and the <i>Zapata</i> Second Step	500
[D] Structural Bias and Other Criticisms	501
[E] Recent Cases	504
§ 14.07 Proposed Reforms of the Modern Strike Suit Era	507
[A] The ALI Proposals Briefly Considered	507
[B] The American Bar Association (Model Business Corporation Act) Proposals	508
[C] Derivative Action Summary	509
[D] Bylaw and Contractual Impediments to Shareholder Litigation	509
§ 14.08 Right to Trial by Jury, Attorneys' Fees, and Miscellaneous Issues	511
[A] Right to Trial by Jury	511
[B] Attorneys' Fees in Derivative Actions	512
[1] Entitlement: Common Fund Versus Common Benefit Cases	512
[2] The Cosmetic (Collusive) Settlement Problem	513
[3] Computation of Fee Amounts: Lodestar Versus Percentage of Recovery Methods	514
[4] Objectors and Intervenor	516
[5] The <i>WorldCom</i> Case	517
[C] Statute of Limitations or Laches?	518
[D] Who Pays?	518
§ 14.09 The Reprise of the Shareholder Class Action	519
[A] The Death of the Derivative Action and the Rise of the "Stock Drop" Class Action	519
[B] The Private Securities Litigation Reform Act (PSLRA) of 1995	521
[C] Particularized Issues Under the PSLRA	522
[1] Pleading	522
[2] Loss Causation	523
[3] Selection of the Most Appropriate Plaintiff	524
[D] The Securities Litigation Uniform Standards Act (SLUSA) of 1998	525
[E] Mail and Wire Fraud Government Criminal Prosecutions	527
§ 14.10 Lawyering Problems in Corporate Litigation	528
[A] Attorney-Client Privilege	528
[B] Attorney-Client Privilege in Derivative Litigation	529
[C] The Corporation as Client	530
[D] Sarbanes-Oxley Act (SOX) § 307: The Conflict Between "Reporting Up" and the Prohibition on Disclosure of Client Confidences	531
§ 14.11 Indemnification and Insurance	532
[A] Overview	532
[B] Indemnification Statutes	533

[C] Advance of Fees and Other Expenses	534
[D] Fees on Fees	535
[E] Implementation by Contract	535
[F] Non-exclusive Versus Exclusive Statutes, Public Policy Limits, and Consistency Limitations	535
[G] Overriding Requirement of Good Faith (Statutory)	536
[H] Insurance	537
[I] Summary	538
 Table of Statues & Regulations	 539
Table of Cases	539
Index	557