

---

# CONTENTS

<i>Preface</i>	<i>xvi</i>
<i>Acknowledgments</i>	<i>xxv</i>

---

	<b>1</b>	
<b>INTRODUCTION TO THE LAW OF ENTERPRISE ORGANIZATION</b>		<b>1</b>
1.1 EFFICIENCY AND THE SOCIAL SIGNIFICANCE OF ENTERPRISE ORGANIZATION		2
1.1.1 Wealth Creation and the Corporate Form of Organization		3
1.1.2 What Do We Mean by Efficiency?		3
1.1.2.1 Pareto Efficiency		4
1.1.2.2 Kaldor-Hicks Efficiency		5
1.2 LAW FROM INSIDE AND OUT: SHARED MEANINGS AND SKEPTICISM		5
1.2.1 The Outside and the Inside		6
1.2.2 Fairness and Efficiency		7
1.3 DEVELOPMENT OF THE MODERN THEORY OF THE FIRM		8
1.3.1 Ronald Coase's 1937 Insight		9
1.3.2 Transactions Cost Theory		9
1.3.3 Agency Cost Theory		10

---

	<b>2</b>	
<b>ACTING THROUGH OTHERS: THE LAW OF AGENCY</b>		<b>15</b>
2.1 INTRODUCTION TO AGENCY		15
2.2 AGENCY FORMATION, AGENCY TERMINATION, AND PRINCIPAL'S LIABILITY		16
2.2.1 Formation		16
2.2.2 Termination		17
2.2.3 Parties' Conception Does Not Control		17
<i>Jenson Farms Co. v. Cargill, Inc.</i>		18

2.2.4	Liability in Contract	21
2.2.4.1	Actual and Apparent Authority	21
	<i>White v. Thomas</i>	22
2.2.4.2	Inherent Authority	25
	<i>Gallant Ins. Co. v. Isaac</i>	26
2.2.5	Liability in Tort	30
	<i>Humble Oil &amp; Refining Co. v. Martin</i>	30
	<i>Hoover v. Sun Oil Co.</i>	32
2.3	THE GOVERNANCE OF AGENCY (THE AGENT'S DUTIES)	34
2.3.1	The Nature of the Agent's Fiduciary Relationship	34
2.3.2	The Agent's Duty of Loyalty to the Principal	35
	<i>Tarnowski v. Resop</i>	36
2.3.3	The Trustee's Duty to Trust Beneficiaries	38
	<i>In re Gleeson</i>	38

<b>THE PROBLEM OF JOINT OWNERSHIP: THE LAW OF PARTNERSHIP</b>		<b>41</b>
3.1	INTRODUCTION TO PARTNERSHIP	41
3.1.1	Why Have Joint Ownership?	42
	Klein & Coffee, The Need to Assemble At-Risk Capital	43
	Hansmann, Kraakman & Squire, Law and the Rise of the Firm	45
3.1.2	The Agency Conflict Among Co-Owners	47
	<i>Meinhard v. Salmon</i>	47
3.2	PARTNERSHIP FORMATION	52
	<i>Vobland v. Sweet</i>	52
3.3	RELATIONS WITH THIRD PARTIES	55
3.3.1	Who Is a Partner?	55
3.3.2	Third-Party Claims Against Departing Partners	56
3.3.3	Third-Party Claims Against Partnership Property	57
3.3.4	Claims of Partnership Creditors to Partner's Individual Property	58
3.4	PARTNERSHIP GOVERNANCE AND ISSUES OF AUTHORITY	61
	<i>National Biscuit Co. v. Stroud</i>	61
3.5	TERMINATION (DISSOLUTION AND DISSOCIATION)	63
3.5.1	Accounting for Partnership's Financial Status and Performance	63
	<i>Adams v. Jarvis</i>	65
	<i>Dreifuerst v. Dreifuerst</i>	69
	<i>Page v. Page</i>	73
3.6	LIMITED LIABILITY MODIFICATIONS OF THE PARTNERSHIP FORM	75
3.6.1	The Limited Partnership	76
3.6.2	Limited Liability Partnerships and Companies	78
3.6.2.1	The Limited Liability Partnership	78
3.6.2.2	The Limited Liability Company	79

		4	
<b>THE CORPORATE FORM</b>			<b>85</b>
4.1	INTRODUCTION TO THE CORPORATE FORM		85
4.2	CREATION OF A FICTIONAL LEGAL ENTITY		87
4.2.1	A Note on the History of Corporate Formation		88
4.2.2	The Process of Incorporating Today		92
4.2.3	The Articles of Incorporation, or “Charter”		93
4.2.4	The Corporate Bylaws		94
4.2.5	Shareholders’ Agreements		95
4.3	LIMITED LIABILITY		96
	Easterbrook & Fischel, Limited Liability and the Corporation		97
4.4	TRANSFERABLE SHARES		99
4.5	CENTRALIZED MANAGEMENT		101
4.5.1	Legal Construction of the Board		102
	4.5.1.1 The Holder of Primary Management Power		102
	<i>Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cunningham</i>		103
	4.5.1.2 Structure of the Board		106
	4.5.1.3 Formality in Board Operation		107
	4.5.1.4 A Critique of Boards		108
4.5.2	Corporate Officers: Agents of the Corporation		110
	<i>Jennings v. Pittsburgh Mercantile Co.</i>		110

		5	
<b>DEBT, EQUITY, AND ECONOMIC VALUE</b>			<b>115</b>
5.1	CAPITAL STRUCTURE		115
5.1.1	Legal Character of Debt		116
5.1.2	Legal Character of Equity		118
5.2	BASIC CONCEPTS OF VALUATION		119
5.2.1	The Time Value of Money		119
5.2.2	Risk and Return		122
5.2.3	Diversification and Systematic Risk		125
5.3	VALUING ASSETS		127
5.3.1	The Discount Cash Flow (DCF) Approach		127
5.3.2	The Relevance of Prices in the Securities Market		129

	6	
<b>THE PROTECTION OF CREDITORS</b>		<b>131</b>
6.1	MANDATORY DISCLOSURE	132
6.2	CAPITAL REGULATION	133
	6.2.1 Financial Statements	133
	6.2.2 Distribution Constraints	137
	6.2.3 Minimum Capital and Capital Maintenance Requirements	139
6.3	STANDARD-BASED DUTIES	140
	6.3.1 Director Liability	141
	6.3.2 Creditor Protection: Fraudulent Transfers	143
	6.3.3 Shareholder Liability	145
	6.3.3.1 Equitable Subordination	145
	<i>Costello v. Fazio</i>	145
	6.3.3.2 Piercing the Corporate Veil	151
	<i>Sea-Land Services, Inc. v. The Pepper Source</i>	152
	<i>Kinney Shoe Corp. v. Polan</i>	157
6.4	VEIL PIERCING ON BEHALF OF INVOLUNTARY CREDITORS	161
	<i>Walkovszky v. Carlton</i>	161
	7	
<b>NORMAL GOVERNANCE: THE VOTING SYSTEM</b>		<b>169</b>
7.1	THE ROLE AND LIMITS OF SHAREHOLDER VOTING	169
7.2	ELECTING AND REMOVING DIRECTORS	172
	7.2.1 Electing Directors	172
	7.2.2 Removing Directors	173
7.3	SHAREHOLDER MEETINGS AND ALTERNATIVES	176
7.4	PROXY VOTING AND ITS COSTS	177
	<i>Rosenfeld v. Fairchild Engine &amp; Airplane Corp.</i>	179
7.5	CLASS VOTING	181
7.6	SHAREHOLDER INFORMATION RIGHTS	183
7.7	TECHNIQUES FOR SEPARATING CONTROL FROM CASH FLOW RIGHTS	184
	7.7.1 Circular Control Structures	185
	<i>Speiser v. Baker</i>	186
	7.7.2 Vote Buying	192
	Easterbrook & Fischel, Voting in Corporate Law	192
	<i>Schreiber v. Carney</i>	193
	7.7.3 Controlling Minority Structures	200
	Bebchuk, Kraakman & Triantis, Stock Pyramids, Cross-Ownership, and Dual Class Equity	200

7.8	THE COLLECTIVE ACTION PROBLEM	204
	Easterbrook & Fischel, Voting in Corporate Law	205
	Black, Next Steps in Proxy Reform	205
	Pozen, Institutional Investors: The Reluctant Activists	207
	Kahan & Rock, Hedge Funds in Corporate Governance and Corporate Control	208
7.9	THE FEDERAL PROXY RULES	209
7.9.1	Rules 14a-1 Through 14a-7: Disclosure and Shareholder Communication	209
7.9.2	Rule 14a-8: Shareholder Proposals <i>CA, Inc. v. AFSCME Employees Pension Plan</i>	213 220
7.9.3	Rule 14a-9: The Antifraud Rule <i>Virginia Bankshares, Inc. v. Sandberg</i>	228 230
7.10	STATE DISCLOSURE LAW: FIDUCIARY DUTY OF CANDOR	236

8

	<b>NORMAL GOVERNANCE: THE DUTY OF CARE</b>	<b>239</b>
8.1	INTRODUCTION TO THE DUTY OF CARE	239
8.2	THE DUTY OF CARE AND THE NEED TO MITIGATE DIRECTOR RISK AVERSION <i>Gagliardi v. TriFoods International, Inc.</i>	240 241
8.3	STATUTORY TECHNIQUES FOR LIMITING DIRECTOR AND OFFICER RISK EXPOSURE	243
8.3.1	Indemnification <i>Waltuch v. Conticommodity Services, Inc.</i>	243 243
8.3.2	Directors and Officers Insurance	249
8.4	JUDICIAL PROTECTION: THE BUSINESS JUDGMENT RULE <i>Kamin v. American Express Co.</i>	250 250
8.4.1	Understanding the Business Judgment Rule	253
8.4.2	The Duty of Care in Takeover Cases: A Note on <i>Smith v. Van Gorkom</i>	255
8.4.3	Additional Statutory Protection: Authorization for Charter Provisions Waiving Liability for Due Care Violations	256
8.5	DELAWARE’S UNIQUE APPROACH TO ADJUDICATING DUE CARE CLAIMS AGAINST CORPORATE DIRECTORS: FROM <i>TECHNICOLOR</i> TO <i>EMERALD PARTNERS</i>	258
8.6	THE BOARD’S DUTY TO MONITOR: LOSSES “CAUSED” BY BOARD PASSIVITY <i>Francis v. United Jersey Bank</i> <i>Graham v. Allis-Chalmers Manufacturing Co.</i> <i>In the Matter of Michael Marchese</i> <i>In re Caremark International Inc. Derivative Litigation</i> <i>In re Citigroup Inc. Shareholder Derivative Litigation</i>	261 263 268 272 278 285

8.7	“KNOWING” VIOLATIONS OF LAW	291
	<i>Miller v. AT&amp;T</i>	291

	<b>CONFLICT TRANSACTIONS: THE DUTY OF LOYALTY</b>	<b>295</b>
9.1	DUTY TO WHOM?	296
9.1.1	The Shareholder Primacy Norm	296
	<i>A.P. Smith Manufacturing Co. v. Barlow</i>	299
9.1.2	Constituency Statutes	301
9.2	SELF-DEALING TRANSACTIONS	302
9.2.1	Early Regulation of Fiduciary Self-Dealing	303
9.2.2	The Disclosure Requirement	304
	<i>State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.</i>	304
9.2.3	Controlling Shareholders and the Fairness Standard	309
	<i>Sinclair Oil Corp. v. Levien</i>	310
9.3	THE EFFECT OF APPROVAL BY A DISINTERESTED PARTY	314
9.3.1	The Safe Harbor Statutes	314
	<i>Cookies Food Products v. Lakes Warehouse</i>	315
9.3.2	Approval by Disinterested Members of the Board	320
	Eisenberg, Self-Interested Transactions in Corporate Law	320
	<i>Cooke v. Oolie</i>	322
9.3.3	Approval by a Special Committee of Independent Directors	325
9.3.4	Shareholder Ratification of Conflict Transactions	326
	<i>Lewis v. Vogelstein</i>	327
	<i>In re Wheelabrator Technologies, Inc.</i>	328
9.4	DIRECTOR AND MANAGEMENT COMPENSATION	330
9.4.1	Perceived Excessive Compensation	331
9.4.2	Option Grants and the Law of Director and Officer Compensation	332
	<i>Lewis v. Vogelstein</i>	332
9.4.3	Regulatory Responses to Executive Compensation	335
9.4.4	The <i>Disney</i> Decision	338
	<i>In re The Walt Disney Company Derivative Litigation</i>	341
9.5	CORPORATE OPPORTUNITY DOCTRINE	348
9.5.1	Determining Which Opportunities “Belong” to the Corporation	348
9.5.2	When May a Fiduciary Take a Corporate Opportunity?	349
9.6	THE DUTY OF LOYALTY IN CLOSE CORPORATIONS	351
	<i>Donabue v. Rodd Electrottype Co.</i>	351
	Easterbrook & Fischel, Close Corporations and Agency Costs	357
	<i>Smith v. Atlantic Properties, Inc.</i>	359

	10	
<b>SHAREHOLDER LAWSUITS</b>		<b>363</b>
10.1 DISTINGUISHING BETWEEN DIRECT AND DERIVATIVE CLAIMS		363
10.2 SOLVING A COLLECTIVE ACTION PROBLEM: ATTORNEYS' FEES AND THE INCENTIVE TO SUE		366
	<i>Fletcher v. A.J. Industries, Inc.</i>	367
10.3 STANDING REQUIREMENTS		373
10.4 BALANCING THE RIGHTS OF BOARDS TO MANAGE THE CORPORATION AND SHAREHOLDERS' RIGHTS TO OBTAIN JUDICIAL REVIEW		375
10.4.1 The Demand Requirement of Rule 23		376
	<i>Levine v. Smith</i>	376
	<i>Rales v. Blasband</i>	381
10.4.2 Special Litigation Committees		388
	<i>Zapata Corp. v. Maldonado</i>	389
	<i>In re Oracle Corp. Derivative Litigation</i>	395
	<i>Joy v. North</i>	403
10.5 SETTLEMENT AND INDEMNIFICATION		407
10.5.1 Settlement by Class Representatives		407
10.5.2 Settlement by Special Committee		408
	<i>Carlton Investments v. TLC Beatrice</i>	
	<i>International Holdings, Inc.</i>	409
10.6 WHEN ARE DERIVATIVE SUITS IN SHAREHOLDERS' INTERESTS?		411

	11	
<b>TRANSACTIONS IN CONTROL</b>		<b>413</b>
11.1 SALES OF CONTROL BLOCKS: THE SELLER'S DUTIES		415
11.1.1 The Regulation of Control Premia		416
	<i>Zetlin v. Hanson Holdings, Inc.</i>	416
	<i>Perlman v. Feldmann</i>	417
11.1.2 A Defense of the Market Rule in Sales of Control		423
	Easterbrook & Fischel, Corporate Control Transactions	423
11.2 SALE OF CORPORATE OFFICE		428
11.3 LOOTING		429
	<i>Harris v. Carter</i>	429
11.4 TENDER OFFERS: THE BUYER'S DUTIES		433
	<i>Brascan Ltd. v. Edper Equities Ltd.</i>	435
11.5 THE HART-SCOTT-RODINO ACT WAITING PERIOD		439

<b>FUNDAMENTAL TRANSACTIONS: MERGERS AND ACQUISITIONS</b>	<b>443</b>
12.1 INTRODUCTION	443
12.2 ECONOMIC MOTIVES FOR MERGERS	444
12.2.1 Integration as a Source of Value	444
12.2.2 Other Sources of Value in Acquisitions: Tax, Agency Costs, and Diversification	445
12.2.3 Suspect Motives for Mergers	446
12.2.4 Do Mergers Create Value?	447
12.3 THE EVOLUTION OF THE U.S. CORPORATE LAW OF MERGERS	448
12.3.1 When Mergers Were Rare	448
12.3.2 The Modern Era	449
12.4 THE ALLOCATION OF POWER IN FUNDAMENTAL TRANSACTIONS	450
12.5 OVERVIEW OF TRANSACTIONAL FORM	452
12.5.1 Asset Acquisition	453
<i>Katz v. Bregman</i>	453
12.5.2 Stock Acquisition	458
12.5.3 Mergers	459
12.5.4 Triangular Mergers	461
12.6 STRUCTURING THE M&A TRANSACTION	462
12.6.1 Timing	462
12.6.2 Regulatory Approvals, Consents, and Title Transfers	463
12.6.3 Planning Around Voting and Appraisal Rights	463
12.6.4 Due Diligence, Representations and Warranties, Covenants, and Indemnification	464
12.6.5 Deal Protections and Termination Fees	465
12.6.6 Accounting Treatment	465
12.6.7 A Case Study: Excerpt from Timberjack Agreement and Plan of Merger	466
12.7 TAXATION OF CORPORATE COMBINATIONS	471
12.7.1 Basic Concepts	471
12.7.2 Tax-Free Corporate Reorganizations	472
12.8 THE APPRAISAL REMEDY	474
12.8.1 History and Theory	474
12.8.2 The Appraisal Alternative in Interested Mergers	476
12.8.3 The Market-Out Rule	478
12.8.4 The Nature of “Fair Value”	478
12.9 THE DE FACTO MERGER DOCTRINE	479
<i>Hariton v. Arco Electronics, Inc.</i>	481
12.10 THE DUTY OF LOYALTY IN CONTROLLED MERGERS	483
12.10.1 Cash Mergers or Freeze-Outs	484
<i>Weinberger v. UOP, Inc.</i>	486
12.10.2 What Constitutes Control and Exercise of Control	497
<i>Kahn v. Lynch Communication Systems, Inc.</i>	497
12.10.3 Special Committees of Independent Directors in Controlled Mergers	502

12.10.4	Controlling Shareholder Fiduciary Duty on the First Step of a Two-Step Tender Offer	504
	<i>In re Pure Resources, Inc., Shareholders Litigation</i>	504

13

<b>PUBLIC CONTESTS FOR CORPORATE CONTROL</b>		<b>511</b>
13.1	INTRODUCTION	511
13.2	DEFENDING AGAINST HOSTILE TENDER OFFERS	515
	<i>Unocal Corp. v. Mesa Petroleum Co.</i>	515
13.3	PRIVATE LAW INNOVATION: THE POISON PILL	522
	<i>Moran v. Household International, Inc.</i>	525
13.4	CHOOSING A MERGER OR BUYOUT PARTNER: <i>REVLON</i> , ITS SEQUELS, AND ITS PREQUELS	533
	<i>Smith v. Van Gorkom</i>	533
	<i>Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc.</i>	541
13.5	PULLING TOGETHER <i>UNOCAL</i> AND <i>REVLON</i>	546
	<i>Paramount Communications, Inc. v. Time, Inc.</i>	547
	<i>Paramount Communications, Inc. v. QVC Network, Inc.</i>	554
	<i>Lyondell Chemical Co. v. Ryan</i>	568
13.6	PROTECTING THE DEAL	575
13.6.1	“No Shops/No Talks” and “Fiduciary Outs”	578
13.6.2	Shareholder Lock-ups	579
	<i>Omnicare, Inc. v. NCS Healthcare, Inc.</i>	579
13.7	STATE ANTITAKEOVER STATUTES	588
13.7.1	First- and Second-Generation Antitakeover Statutes (1968–1987)	588
	<i>CTS Corp. v. Dynamics Corp. of America</i>	589
13.7.2	Third-Generation Antitakeover Statutes (1987–2000)	593
13.8	PROXY CONTESTS FOR CORPORATE CONTROL	597
	<i>Schnell v. Chris-Craft Industries, Inc.</i>	598
	<i>Blasius Industries, Inc. v. Atlas Corp.</i>	599
13.9	THE TAKEOVER ARMS RACE CONTINUES	606
13.9.1	“Dead Hand” Pills	606
13.9.2	Mandatory Pill Redemption Bylaws	608
	<i>Unisuper v. News Corp.</i>	610

14

<b>TRADING IN THE CORPORATION’S SECURITIES</b>		<b>615</b>
14.1	COMMON LAW OF DIRECTORS’ DUTIES WHEN TRADING IN THE CORPORATION’S STOCK	615

	<i>Goodwin v. Agassiz</i>	616
14.2	THE CORPORATE LAW OF FIDUCIARY DISCLOSURE TODAY	620
14.2.1	Corporate Recovery of Profit from “Insider” Trading	621
	<i>Freeman v. Decio</i>	622
14.2.2	Board Disclosure Obligations Under State Law	625
14.3	EXCHANGE ACT §16(B) AND RULE 16	626
14.4	EXCHANGE ACT §10(B) AND RULE 10B-5	629
14.4.1	Evolution of Private Right of Action Under §10	630
14.4.2	Elements of a 10b-5 Claim	631
14.4.2.1	Elements of a 10b-5 Claim: False or Misleading Statement or Omission	632
	<i>SEC v. Texas Gulf Sulphur Co.</i>	633
	<i>Santa Fe Industries Inc. v. Green</i>	639
14.4.2.2	Elements of 10b-5 Liability: The Equal Access Theory	646
14.4.2.3	Elements of 10b-5 Liability: The Fiduciary Duty Theory	647
	<i>Chiarella v. United States</i>	649
	<i>Dirks v. SEC</i>	653
	<i>United States v. Chestman</i>	662
	<i>United States v. O’Hagan</i>	667
14.4.2.4	Elements of 10b-5 Liability: Materiality	672
	<i>Basic Inc. v. Levinson</i>	672
14.4.2.5	Elements of 10b-5 Liability: Scierter	676
14.4.2.6	Elements of 10b-5 Liability: Standing, in Connection with the Purchase or Sale of Securities	678
14.4.2.7	Elements of 10b-5 Liability: Reliance	679
	<i>Basic Inc. v. Levinson</i>	679
14.4.2.8	Elements of 10b-5 Recovery: Causation	685
14.4.3	Remedies for 10b-5 Violations	686
	<i>Elkind v. Liggett &amp; Myers, Inc.</i>	686
14.4.4	The Academic Debate	690
14.4.4.1	Insider Trading and Informed Prices	691
14.4.4.2	Insider Trading as a Compensation Device	693
	Are Deal Makers on Wall Street Leaking Secrets?	695
	<i>Table of Cases</i>	697
	<i>Index</i>	703