

Understanding

CORPORATE LAW

FOURTH EDITION



Arthur R. Pinto
Douglas M. Branson

UNDERSTANDING CORPORATE LAW

FOURTH EDITION

Arthur R. Pinto

*Professor of Law & Co-Director of the
Center for the Study of International Business Law
Brooklyn Law School*

Douglas M. Branson

*W. Edward Sell Chair in Business Law
University of Pittsburgh School of Law*

Library of Congress Cataloging-in-Publication Data

Pinto, Arthur R.

Understanding corporate law / Arthur R. Pinto, Professor of Law & Co-Director of the Center for the Study of International Business Law, Brooklyn Law School; Douglas M. Branson, W. Edward Sell Chair in Business Law, University of Pittsburgh School of Law. -- Fourth edition.

p. cm.

Includes index.

ISBN 978-0-7698-6512-6 (softbound)

I. Corporation law -- United States. I. Branson, Douglas M. II. Title.

KF1414.P56 2013

346.73'066--dc23

2013025875

ISBN: 978-0-7698-6512-6

eBook ISBN: 978-0-3271-8984-8

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. Matthew Bender and the Matthew Bender Flame Design are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2013 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved.

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

NOTE TO USERS

To ensure that you are using the latest materials available in this area, please be sure to periodically check the LexisNexis Law School web site for downloadable updates and supplements at www.lexisnexis.com/lawschool.

Editorial Offices

121 Chanlon Rd., New Providence, NJ 07974 (908) 464-6800

201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200

www.lexisnexis.com

MATTHEW  BENDER

PREFACE

Understanding Corporate Law is intended to assist law students and lawyers with a basic understanding of the law of corporations as taught in most corporations courses. Significant business, economic and policy issues are highlighted in connection with a thorough analysis of the important cases and both state and federal statutory provisions used in the study of corporations. It includes the major theoretical approaches used in current corporate law literature. In each chapter, the authors identify important policies and discuss the relationship of the law as it has developed to those policies. Statutory issues are covered under both the General Corporation Law of the State of Delaware and the Business Corporation Act. In addition, significant sections from the Principles of Corporate Governance of the American Law Institute are covered. The corporate scandals of 2001 and 2002, the enactment of the federal Sarbanes-Oxley (2002), Dodd-Frank (2010), and JOBS (2012) Acts, and the financial crisis of 2008 are also covered. Chapter 11 now incorporates significant new material on limited liability companies (LLCs). This book is designed to be used with all of the major corporate law casebooks.

We also have written this volume so that non-lawyers who desire to progress beyond a rudimentary knowledge of corporate law may do so by reading this book.

Although the book was a collaborative effort, Professor Pinto wrote Chapters 1, 4, 5, 6, 8, 9, 10 and 12. Professor Branson wrote Chapters 2, 3, 7, 11, 13 and 14.

Professor Pinto would like to acknowledge the helpful suggestions on the chapters he wrote from his colleague Professor Brackman Reiser. In addition, he would like to thank Braden Hasnay, Brooklyn Law School Class of 2014, for his editorial assistance. He would like to also acknowledge Stephen J. Bohlen for his constant support.

Professor Branson dedicates this book to Elizabeth, Clare and Annie.

The book is dedicated to our students past and present who have inspired this project.

Arthur R. Pinto

Douglas M. Branson

TABLE OF CONTENTS

Chapter 1	INTRODUCTION AND FORMATION	1
§ 1.01	INTRODUCTION	1
§ 1.02	SOURCES OF CORPORATE LAW	4
§ 1.03	HISTORICAL BACKGROUND	5
§ 1.04	CHOICE OF FORM	6
[A]	Sole Proprietorship	6
[B]	Partnership vs. Corporation	6
§ 1.05	LIMITED PARTNERSHIPS	10
§ 1.06	LIMITED LIABILITY COMPANY	11
§ 1.07	TAXATION	11
[A]	Double Taxation	12
[1]	Subchapter S Corporation	13
[2]	Limited Liability Companies	13
§ 1.08	INCORPORATION AND ORGANIZATION	14
§ 1.09	CHOICE OF LAW	15
[A]	Delaware's Dominance	16
§ 1.10	ULTRA VIRES	18
[A]	Corporate Social Responsibility and Philanthropy	19
§ 1.11	SOCIAL BENEFIT ORGANIZATIONS	20
Chapter 2	PROMOTERS' LIABILITY AND DEFECTIVE INCORPORATION	23
§ 2.01	INTRODUCTION	23
§ 2.02	PROMOTERS' LIABILITY ON PREINCORPORATION CONTRACTS	24
[A]	Overview	24
[B]	Liability of the Promoter	24
[C]	The Strict View of Promoters' Liability	25
[D]	Reliance on the Intent of the Parties	26
[E]	Liability of the Newly Formed Corporation or LLC	28
[F]	Promoters' Fiduciary Duties	30
§ 2.03	DEFECTIVE INCORPORATION	30
[A]	The Problem	30
[B]	The De Facto Corporation Doctrine and Corporation by Estoppel	32
[C]	Statutory Abolition of the De Facto Corporation Doctrine	33
[D]	Does Corporation by Estoppel Survive the Model Business Corporation Act?	34
[E]	Model Business Corporation Act Compromise	35

Table of Contents

[F]	Corporate Death	35
Chapter 3	PIERCING THE CORPORATE VEIL	37
§ 3.01	THE CONCEPT OF LIMITED LIABILITY	37
§ 3.02	THE LIMITED LIABILITY DEBATE	39
§ 3.03	GROUND FOR PIERCING THE CORPORATE VEIL	41
[A]	Introduction	41
[B]	Intermixture of Affairs	42
[C]	Lack of Corporate Formalities	44
[D]	Veil Piercing in Limited Liability Companies (LLCs)	45
[E]	Inadequate Capitalization	45
[1]	Overview	45
[2]	What is Capital for These Purposes?	46
[3]	When is Capital Adequate?	46
[4]	Is Inadequate Capitalization Alone a Sufficient Ground?	47
[5]	Does a Duty Ever Arise to “Top Off” the Original Capital?	49
[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	52
§ 3.04	EQUITABLE SUBORDINATION	53
§ 3.05	PIERCING THE CORPORATE VEIL: PROCEDURAL CONTEXTS ...	55
§ 3.06	STATUTORY LIABILITY UNDER ENVIRONMENTAL LAWS	56
§ 3.07	SUCCESSOR CORPORATION LIABILITY IN PRODUCTS LIABILITY	57
§ 3.08	PIERCING THE CORPORATE VEIL — STRUCTURAL SETTINGS ..	58
[A]	Personal Shareholder Liability	58
[B]	Parent-Subsidiary Settings	61
[C]	Brother-Sister (Sibling) Corporation Settings	63
[D]	Enterprise Liability	67
[E]	Reverse Piercing	68
[F]	Participation	69
[G]	Summary	69
Chapter 4	FINANCING THE CORPORATION	71
§ 4.01	INTRODUCTION	71
§ 4.02	SECURITIES	72
[A]	Debt	72
[B]	Common Shares	73
[C]	Preferred Shares	74
§ 4.03	LEVERAGING AND CAPITAL STRUCTURE	75

Table of Contents

§ 4.04	LEGAL CAPITAL RULES	76
[A]	Preemptive Rights	77
[B]	Par Value	78
[C]	Dividends and Repurchases of Shares	79
§ 4.05	VALUATION	80
[A]	Liquidation Value	81
[B]	Book Value	81
[1]	Cost Based Accounting	82
[2]	Depreciation	82
[3]	Intangible Assets	83
[C]	Earnings Approach	83
[1]	Capitalization of Earnings	84
[2]	Cash Flow as Earnings	85
[3]	The Rate	86

Chapter 5	THE LEGAL MODEL AND CORPORATE GOVERNANCE: THEMES AND THE ALLOCATION OF POWER UNDER STATE LAW	89
------------------	---	-----------

§ 5.01	INTRODUCTION	89
§ 5.02	THEMES	90
[A]	Focus of Corporate Governance and Stakeholders	91
[B]	Publicly Held Corporation	94
[C]	The Stock Markets	95
[1]	Benefits of Stock Markets	96
[2]	Shareholder Protection and Stock Markets	98
[D]	The Efficient Capital Market Hypothesis	98
[E]	Role of Ownership	100
[1]	The Berle-Means Corporation-Separation of Ownership from Control	100
[2]	Institutional Investors	101
[3]	Political Significance of Share Ownership	103
[F]	Independent Directors	104
[G]	Gatekeepers	106
[H]	Federalism	107
[I]	Publicly Held vs. Closely Held Corporations	108
§ 5.03	THEORIES OF THE FIRM	109
[A]	Regulatory Approach	109
[B]	Management, Director, or Shareholder Approach	110
[C]	Law and Economics Approach	110
[1]	Agency Costs	111
[2]	Markets	111

Table of Contents

[3]	Nexus of Contracts	112
[4]	Critics of Contractual Approach	112
[5]	Behavioral Economics	113
§ 5.04	THE LEGAL MODEL	114
§ 5.05	SHAREHOLDERS	114
[A]	Right to Vote	115
[1]	Cumulative Voting	117
[2]	Right of Expression	118
[B]	Proxy Voting	119
[C]	The Proxy Fight	121
[1]	Change Management	121
[2]	Replace Directors to Facilitate an Acquisition	122
[3]	Change Policy	122
[i]	Shareholder Proposals	122
[ii]	Withholding Votes	124
[iii]	Nominating Directors in Management's Proxy Statement	125
[4]	Collective Action Problem	126
[5]	Proxy Expenses	126
[D]	Shareholder Democracy	127
[1]	Fiduciary Duty	128
[E]	Vote Buying	132
[F]	Right to Information	133
§ 5.06	BOARD OF DIRECTORS	136
[A]	Board Structure	136
[B]	Meetings	137
[1]	Actions Without a Meeting	137
§ 5.07	OFFICERS	139
[A]	Authority	139
§ 5.08	FINANCIAL SCANDALS	141
[A]	The Sarbanes-Oxley Act of 2002	141
[B]	Dodd Frank-Act of 2010	146

Chapter 6 MERGERS AND ACQUISITIONS 149

§ 6.01	INTRODUCTION	149
§ 6.02	MERGERS	149
[A]	Triangular Merger	151
[B]	Reverse Triangular Merger	152
[C]	Short Form Merger	153
§ 6.03	SALE OF ASSETS	154
§ 6.04	TENDER OFFER	155
§ 6.05	OTHER LEGAL ISSUES	156

Table of Contents

§ 6.06	APPRAISAL REMEDY	157
[A]	Delaware Block Approach	159
[1]	The New Delaware Methodology	161
[B]	Stock Market Exception	162
§ 6.07	DE FACTO MERGERS	162
Chapter 7	INTRODUCTION TO FEDERAL REGULATION AND THE PROXY RULES	165
§ 7.01	INTRODUCTION AND OVERVIEW	165
§ 7.02	SEC JURISDICTION AND PERIODIC REPORTING BY PUBLICLY HELD CORPORATIONS	167
[A]	SEC Jurisdiction	167
[B]	Periodic Reporting — An Overview	169
[C]	Certifications, Code of Ethics Disclosure, and Penalties for Earnings Restatements	170
[D]	Private Securities Litigation Reform Act (PSLRA) Safe Harbor for Forward Looking Statements	171
[E]	Management Discussion and Analysis (MD&A)	171
[F]	Earnings Management and Revenue Recognition Issues	172
§ 7.03	SECURITIES ISSUANCE	173
[A]	The Federal Disclosure Philosophy	173
[B]	Registration Requirements	175
[C]	The Registration Process	177
[D]	Exemptions From Registration	179
[1]	Scope	179
[2]	The Intrastate Exemption	179
[3]	The Private Offering Exemption	180
[4]	Regulation D Exemptions	182
§ 7.04	PROXY REGULATION	183
[A]	Introduction	183
[B]	A Proxy Solicitation Hypothetical	185
[C]	Proxy Contests	186
[1]	The Shareholder's Role	186
[2]	Inadvertent Solicitation and Other Problems	187
[3]	Regulatory Burdens and Costs	189
[4]	Proxy Contest Procedures and Further Costs	189
[D]	Use of Shareholder Consents	191
[E]	The Internet and the "Notice and Access" Proxy Regime	191
§ 7.05	THE SEC SHAREHOLDER PROXY PROPOSAL RULE: SEC RULE 14a-8	193
[A]	Proposals	193

Table of Contents

[B]	Eligibility and Procedure	194
[C]	Background on the Nature of the Proposals	195
[D]	Mechanics of the Shareholder Proxy Proposal Process	196
[E]	The 14a-8, Question 9(7), Ordinary Business Operations Exclusion . . .	199
[F]	Other Rule 14a-8 Exclusions	202
[G]	Proposals to Amend Corporate Bylaws	202
[H]	<i>CA, Inc. v. AFSCME Employees Pension Trust</i>	204
§ 7.06	THE PROXY RULES' GENERAL ANTIFRAUD RULE: AN INTRODUCTION TO GENERAL DISCLOSURE LAW CONCEPTS . .	206
[A]	Introduction	206
[B]	SEC Rule 14a-9	207
[C]	Implication of Private Rights of Action	209
[D]	Standing to Sue	211
[E]	Materiality of the Omission of the Misleading Statement	212
[F]	State of Mind (Fault) Required	214
[G]	Causation	215
[H]	Remedies	219
Chapter 8	INTRODUCTION TO FIDUCIARY DUTY: THE DUTY OF CARE, THE BUSINESS JUDGMENT RULE AND GOOD FAITH	221
§ 8.01	INTRODUCTION	221
[A]	Overview of Duty of Care and Loyalty	222
[B]	Sliding Scale	223
§ 8.02	POLICY ISSUES	224
[A]	Law and Economics Approach	225
§ 8.03	DUTY OF CARE	226
[A]	Nonfeasance	228
[B]	Malfeasance and the Business Judgment Rule	229
[C]	Causation	232
§ 8.04	THE <i>SMITH</i> v. <i>VAN GORKOM</i> CASE	233
§ 8.05	THE DEMISE OF THE DUTY OF CARE	236
[A]	Delaware General Corporation Law § 102(b)(7)	236
§ 8.06	GOOD FAITH	238
[A]	<i>Disney</i> Litigation and Good Faith	238
[B]	The Duty to Monitor and <i>Stone v. Ritter</i>	240
§ 8.07	DUTY OF DISCLOSURE	244
§ 8.08	DUTY TO ACT LAWFULLY	245

Table of Contents

Chapter 9	THE DUTY OF LOYALTY AND CONFLICTS OF INTEREST	247
§ 9.01	INTRODUCTION	247
§ 9.02	POLICY	248
§ 9.03	INTERESTED DIRECTOR TRANSACTIONS	250
[A]	Common Law	252
[B]	Statutory Responses	253
[1]	Weak Form Approach	256
[2]	Semi-Strong Approach	257
[a]	The New York Approach	257
[b]	The Current California Approach	258
[3]	Strong Form Approach	258
[a]	Delaware Approach	258
[b]	The MBCA Approach	260
§ 9.04	EXECUTIVE COMPENSATION	261
[A]	Stock Options	265
[B]	Good Faith and Compensation	267
[C]	Waste	269
[1]	Delaware's Waste Standard	270
§ 9.05	CORPORATE OPPORTUNITY AND ABUSE OF POSITION	272
[A]	Legal Tests	273
[1]	Interest Test	273
[2]	Line of Business Test	274
[3]	Fairness Test	275
[4]	The ALI Test	275
[B]	Financial Inability	277
[C]	Multiple Boards	277
[D]	Use of Information and Competition	278
[E]	Undisclosed Profits	279
§ 9.06	SHAREHOLDER VOTING AND RATIFICATION	279
[A]	Required Voting	280
[B]	Optional Shareholder Voting and Ratification	281
Chapter 10	CONTROLLING SHAREHOLDERS	285
§ 10.01	INTRODUCTION	285
§ 10.02	USE OF CONTROL	287
[A]	The <i>Zahn</i> Case	287
[B]	Parent-Subsidiary Dealings	288
[C]	Sale of Corporation	290
§ 10.03	FREEZEOUTS	291
[A]	Policy Issues	292

Table of Contents

[B]	State Law	295
[C]	Cases	297
[1]	The <i>Weinberger</i> Case	297
[2]	Post <i>Weinberger</i> Cases	300
[a]	Appraisal versus Equity in Delaware	300
[b]	Fair Dealing	301
[i]	Negotiating Committee of Independent Directors	302
[ii]	Majority of Minority Shareholder Voting	304
[c]	Business Purpose	305
[d]	The Controlling Shareholder's Tender Offer	306
[D]	Federal Law	308
[1]	SEC Rule 13e-3	308
[2]	SEC Rule 10b-5	309
§ 10.04	SALE OF CONTROL	311
[A]	Looting	314
[B]	The <i>Perlman</i> Case	315
[C]	The California Approach	316
[D]	Sale of Office	319

Chapter 11 SPECIAL PROBLEMS OF THE CLOSELY HELD CORPORATION 321

§ 11.01	INTRODUCTION AND OVERVIEW	321
[A]	Definitions of a Close Corporation	321
[B]	Illiquidity and Exploitation	322
[C]	Corporate Law Responses to the Illiquidity and Exploitation Situation	323
§ 11.02	OBTAINING AND MAINTAINING A MEASURE OF CONTROL	324
[A]	Preview	324
[B]	Shareholder Voting Agreements	325
[C]	Irrevocable Proxies	327
[D]	Voting Trusts	328
[E]	Class Voting	332
[F]	Cumulative Voting	333
[G]	Summary	333
§ 11.03	PROTECTING SHAREHOLDER EXPECTATIONS IN CLOSELY HELD CORPORATIONS <i>EX ANTE</i>	334
[A]	Contract	334
[B]	Long-Term Shareholder Tenure and Salary Agreements	334
[C]	Less Than Unanimous Shareholder Agreements	336
[D]	Other Agreements Affecting Directors' Discretion	337
[E]	Comprehensive Shareholder Agreements	339
§ 11.04	RESTRICTIONS ON SHARE TRANSFERABILITY	341

Table of Contents

[A]	Introduction	341
[B]	Umbrella Test — Unreasonable Restraint Upon Alienation?	342
[C]	Other Legal Aspects of Share Transfer Restrictions	344
[1]	Legal Capital and Funding	344
[2]	Procedural Aspects	344
[3]	Disparity Between Buy-Out Price or Formula and Fair Price	345
[4]	Implied Covenant of Good Faith and Fair Dealing	346
[5]	Notice	347
§ 11.05	OTHER GOVERNANCE FEATURES OF THE CLOSELY HELD CORPORATION	348
[A]	Overview	348
[B]	Greater Than Majority Quorum and Voting Requirements	348
[C]	Informal Action By Shareholders and Directors	350
§ 11.06	CLOSE CORPORATION STATUTES	350
§ 11.07	PROTECTING SHAREHOLDER EXPECTATIONS IN THE CLOSE CORPORATION <i>EX POST</i>	351
[A]	Resetting the Problem	351
[B]	Heightened Fiduciary Duty in the Close Corporation Setting	353
[C]	Heightened Fiduciary Duty in Other Jurisdictions	356
[D]	Two Worlds Collide: The <i>Donahue</i> Principle Meets Employment at Will	357
[E]	Involuntary Dissolution Statutes	359
[F]	Cases of Deadlock	360
[G]	Oppression Grounds	362
[H]	Remedies in Involuntary Dissolution Cases	364
[I]	Valuation Issues in Court Ordered Buyouts	367
[J]	Conclusion	368
§ 11.08	LIMITED LIABILITY COMPANIES	369
[A]	Introduction	369
[1]	Hybrid Nature	369
[2]	Manager-Managed	369
[3]	Comparison with Limited Partnership	370
[4]	Comparison with the Limited Partnership Hybrid	370
[B]	Background	370
[C]	Formation of an LLC	371
[D]	Finance	372
[E]	Veil Piercing in LLCs	373
[F]	Authority of Members and Managers	373
[G]	Fiduciary Duties of LLC Managers and Members	374
[1]	Introduction	374
[2]	Implied Covenant of Good Faith and Fair Dealing	375
[3]	The Duty of Loyalty	375

Table of Contents

[4]	Competition with the LLC	377
[5]	Opting out of Fiduciary Duties	377
[6]	Exculpatory Provisions	378
[H]	Dissolution of an LLC	379
[I]	Limited Liability Partnerships	380
[J]	Series	382
[K]	Social Enterprises, Mission Driven Companies, and the Low Profit Limited Liability Company (L3C)	382
Chapter 12	HOSTILE TENDER OFFERS	385
§ 12.01	INTRODUCTION	385
§ 12.02	THE RISE AND FALL OF HOSTILE TENDER OFFERS	386
§ 12.03	POLICY ISSUES	388
[A]	Proponents	388
[B]	Opponents	389
§ 12.04	TACTICS	391
[A]	Bidder Tactics	392
[B]	Target Tactics	394
[1]	Poison Pills	396
§ 12.05	STATE LAW	400
[A]	Delaware Approach	401
[1]	The <i>Cheff</i> Case	401
[2]	The <i>Unocal</i> Test	402
[3]	The <i>Revlon</i> Test	404
[4]	The <i>Time</i> Case	405
[5]	The <i>QVC</i> Case	407
[6]	The <i>Unitrin</i> Case	410
[7]	Shareholder Voting and Tender Offers	411
[8]	Judicial Scrutiny of Deal Protection	413
[a]	The <i>Omnicare</i> Case (Using <i>Unocal</i>)	413
[b]	The <i>Lyondell</i> Case (Using <i>Revlon</i>)	416
[9]	Summary	417
§ 12.06	FEDERAL SECURITIES LAW — THE WILLIAMS ACT	420
[A]	History	420
[B]	Disclosure Rules	421
[C]	Other Rules	422
[D]	Section 14(e)	422
§ 12.07	STATE TAKEOVER STATUTES	423
[A]	Introduction	423
[B]	Policy Issues	425
[C]	Constitutionality	426

Table of Contents

[1]	The <i>Edgar</i> Case	426
[2]	The <i>CTS</i> Case	427
Chapter 13	SEC RULE 10b-5 DISCLOSURE AND INSIDER TRADING	431
§ 13.01	SEC RULE 10b-5 DISCLOSURE AND INSIDER TRADING	431
§ 13.02	DISCLOSURE CONCEPTS AND ELEMENTS OF A CAUSE OF ACTION UNDER RULE 10b-5	434
[A]	Implication of Private Rights of Action	434
[B]	Standing to Sue	434
[C]	Materiality	436
[D]	State of Mind	439
[E]	Pleading State of Mind	442
[F]	Reliance (Transaction Causation)	444
[G]	The Fraud on the Market Theory Reliance Substitute	446
[H]	Loss Causation	448
[I]	The “In Connection With” Requirement	449
[J]	Privity	450
[K]	Secondary Liability for Disclosure Violations	450
[L]	Statutes of Limitation	453
§ 13.03	THE PROHIBITION OF INSIDER TRADING: IS IT GOOD OR BAD?	453
§ 13.04	THE LAW OF INSIDER TRADING	456
[A]	Common Law Background	456
[B]	The Nature of the Insider Trading Prohibition	457
[C]	Who is an Insider?	458
[D]	Tipper-Tippee Liability	461
[E]	The Misappropriation Theory	463
[F]	The Misappropriation Theory in the Supreme Court	465
[G]	Tippees of Misappropriators	469
[H]	Remedies and Enforcement	469
[I]	SEC Regulation FD	472
§ 13.05	THE INSIDER TRADING PROHIBITION UNDER STATE LAW	473
[A]	Common Law	473
[B]	Common Law Exceptions: The Kansas Rule	474
[C]	Common Law Exceptions: Special Facts Doctrine	475
[D]	Modern Expansion of the Special Facts Doctrine	475
[E]	Finding Harm to the Corporation from the Insider’s Trading	476
§ 13.06	REGULATION OF INSIDER TRADING UNDER SECTION 16 OF THE SECURITIES EXCHANGE ACT OF 1934	477
[A]	Statutory Provisions	477
[B]	Parties Plaintiff and Calculation of Damages	478

Table of Contents

[C]	Who is an Officer for Section 16 Purposes?	479
[D]	Insider Status at Only One End of a Swing	480
[E]	Takeover Players and Section 16(b)	480
Chapter 14	CORPORATE LITIGATION	483
§ 14.01	INTRODUCTION	483
§ 14.02	THE NATURE OF THE DERIVATIVE SUIT: DIRECT VERSUS DERIVATIVE, PRO RATA RECOVERY, AND OTHER PRELIMINARY ISSUES	485
[A]	The Nature of the Derivative Suit	485
[B]	Direct Versus Derivative — Special or Distinct Injury Rule	487
[C]	Direct Versus Derivative — Denial of Contract Rights Associated With Shareholding	489
[D]	Direct Versus Derivative — Closely Held Corporation Exception	490
[E]	Pro Rata (Individual) Recovery in Derivative Actions	492
[F]	The <i>Tooley</i> Test in Delaware	494
§ 14.03	QUALIFICATIONS OF A PROPER PLAINTIFF-SHAREHOLDER	495
[A]	Record Ownership	495
[B]	Contemporaneous Ownership	496
[1]	Introduction	496
[2]	Basis for the Rule	496
[3]	Possible Exception: Undisclosed Wrongdoing	498
[4]	Exception: Continuing Wrong	498
[5]	Exception: Double Derivative Actions	499
[C]	Continuous Owner	499
[D]	Clean Hands Requirement	501
[E]	Adequate Representation Requirement	501
[F]	Selection of Lead Counsel	503
§ 14.04	REFORMS OF THE EARLIER STRIKE SUIT ERA	504
[A]	Overview	504
[B]	Verification Requirement	504
[C]	Security for Expenses Requirements	505
§ 14.05	THE DEMAND RULE	506
[A]	Overview	506
[B]	Demand Refused	507
[C]	Demand Accepted	508
[D]	Demand Excused	509
[1]	Introduction	509
[2]	The Futility Exception	510
[a]	Introduction	510
[b]	Legal Tests for Demand Futility	510

Table of Contents

[c]	Disabling Conflicts of Interest	512
[d]	Lack of Independence	513
[3]	Threat of Irreparable Harm	515
[4]	Closely Held Corporations	515
[5]	Delay	515
[6]	Neutrality	516
[E]	Demand on Shareholders	516
§ 14.06	TERMINATION OF LITIGATION: THE ADVENT OF THE SPECIAL LITIGATION COMMITTEE DEVICE	517
[A]	Background	517
[B]	Application of the Business Judgment Rule	519
[C]	Delaware and the <i>Zapata</i> Second Step	520
[D]	Structural Bias and Other Criticisms	521
[E]	Recent Cases	524
§ 14.07	PROPOSED REFORMS OF THE MODERN STRIKE SUIT ERA	528
[A]	The ALI Proposals Briefly Considered	528
[B]	The American Bar Association (Model Business Corporation Act) Proposals	529
[C]	Summary	530
§ 14.08	RIGHT TO TRIAL BY JURY, ATTORNEYS' FEES, AND MISCELLANEOUS ISSUES	531
[A]	Right to Trial by Jury	531
[B]	Attorneys' Fees in Derivative Actions	532
[1]	Entitlement: Common Fund Versus Common Benefit Cases	532
[2]	The Cosmetic (Collusive) Settlement Problem	533
[3]	Computation of Fee Amounts: Lodestar Versus Percentage of Recovery Methods	534
[4]	Objectors and Intervenors	536
[5]	The <i>WorldCom</i> Case	537
[C]	Statute of Limitations or Laches?	538
[D]	Who Pays?	539
§ 14.09	THE REPRIS OF THE SHAREHOLDER CLASS ACTION	539
[A]	The Death of the Derivative Action and the Rise of the "Stock Drop" Class Action	539
[B]	The Private Securities Litigation Reform Act (PSLRA) of 1995	540
[C]	Particularized Issues Under the PSLRA	542
[1]	Pleading	542
[2]	Loss Causation	543
[3]	Selection of the Most Appropriate Plaintiff	544
[D]	The Securities Litigation Uniform Standards Act (SLUSA) of 1998	545
[E]	Mail and Wire Fraud Government Criminal Prosecutions	547
§ 14.10	LAWYERING PROBLEMS IN CORPORATE LITIGATION	547