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Commentaries and Cases on the
LAW OF
BUSINESS ORGANIZATION

*Third
Edition*



Wolters Kluwer

Law & Business

ASPEN PUBLISHERS



30807803

COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION

THIRD EDITION

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Wolters Kluwer

Law & Business

AUSTIN BOSTON CHICAGO NEW YORK THE NETHERLANDS

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Aspen Publishers
Attn: Order Department
PO Box 990
Frederick, MD 21705

Printed in the United States of America.

2 3 4 5 6 7 8 9 0

ISBN 978-0-7355-8600-0

Library of Congress Cataloging-in-Publication Data

Allen, William T.

Commentaries and cases on the law of business organization / William T. Allen, Reinier Kraakman, Guhan Subramanian. — 3rd ed.
p. cm.

ISBN 978-0-7355-8600-0

1. Corporation law—United States—Cases. 2. Business enterprises—Law and legislation—United States—Cases. I. Kraakman, Reinier H. II. Subramanian, Guhan. III. Title.

KF1413.A435 2009

346.73'065—dc22

2009022184



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*To those from whom I learned this subject:
the late S. Samuel Arsht of the Delaware bar and those still
contributing; Andrew B. Kirkpatrick of the Delaware bar; Martin
Lipton of the New York bar; Hon. Walter K. Stapleton of the Third
Circuit Court of Appeals; and my former colleagues on the Court of
Chancery of the State of Delaware, with my deep thanks.*

—William T. Allen

*To those who have made this casebook possible:
especially Victor Brudney, whose generous assistance with
materials rescued me during my first year of teaching corporate
law, and whose advice and criticism have been invaluable ever
since; and my wife, Catherine Krupnick, for her interest, sympathy,
and enthusiasm for this project over the years.*

—Reinier Kraakman

*To my mentors in corporate law, Lucian Bebchuk and
John Coates; and to my wife, Helen Clement, and
my parents, Narayanan and Padma Subramanian.*

—Guhan Subramanian

PREFACE

This book represents our effort to assist students and non-specialist lawyers to achieve an understanding of the basic principles of law that undergird the legal structures within which business is conducted in the United States. Our approach in this effort is premised upon a functional perspective of law. Thus, we attempt to ask how these legal structures function to produce desired benefits to parties who enter into agreements and relationships, or how legal structures (or rules) add costs and can impede sensible business organization. In this second aspect, the analytical or critical perspective, our point of view is informed through our understanding of basic principles of economics. The book, however, requires of its readers no formal training or understanding of economics. The concepts are for the most part quite intuitive and easily grasped.

We have organized the book into two segments. The first (and shorter) of these segments—Chapters 1-5—deals with the fundamentals of organizational law in a business setting. Here the briefest chapter—Chapter 1—addresses the most basic questions: the role of efficiency as a yardstick for evaluating business law, and the fundamental tension between the perspectives of doctrine and policy analysis that most experts (including judges) bring to the analysis of business law. We place these topics first because they come first logically. This does not mean, however, that they must come first pedagogically. Some users of this casebook might wish to circle back to Chapter 1, as students become more familiar with the legal problems posed by business organizations.

Chapters 2-4 deal with the elemental forms of business organization. Chapter 2 focuses on agency law, which is no less a predicate for modern enterprises functioning in a market economy than contract or property law. Chapter 3 addresses the partnership form and its modern variants: the limited partnership, limited liability company, and limited liability partnership. Chapter 4 introduces the corporate form, explicitly contrasted against the partnership and its variants, such as the LLC.

Chapter 5 steps outside the usual progression of a text on business organizations to address rudimentary concepts in valuation. As with Chapter 1, our placement of Chapter 5 seems logical to us, but we recognize that it might also have come earlier or later in the book. On the one hand, valuation issues gain salience as the materials progress further into corporate law, which argues for a later discussion. On the other hand, the basic concepts in financial economics are arguably useful throughout, and so might come at the outset of a course. Again, we are confident that

individual instructors can best decide when, and whether, to work through this brief valuation chapter.

The larger segment of the book, Chapters 6-14, addresses the legal regulation of a variety of actions, decisions, and transactions that involve or concern the modern public corporation. Chapter 6 explores relationships among shareholders, corporations, and corporate creditors. Chapters 7 and 8 explore what we term “normal governance”—that is, the legal framework that regulates the vast majority of the corporation’s ordinary business activities. Chapter 7 addresses the routine functioning of the voting system, including the proxy rules. Chapter 8 explores the duty of care, together with the multiple legal devices that insulate corporate officers and directors from shareholder liability, including, most notably, the business judgment rule.

Chapters 9-13 are devoted to particular classes of corporate actions and related shareholder transactions that are subject to more specialized regulation by corporate law. Chapter 9 addresses self-dealing and other potential duty of loyalty issues arising from the conduct of corporate officers, directors, and controlling shareholders. Chapter 10 extends this discussion to issues of procedure and enforcement by reviewing the law and practice of shareholder derivative suits. Chapter 11 examines transactions in corporate control, including sales of control blocks and tender offers. Chapter 12 addresses the specialized legal treatment of so-called fundamental corporate actions, with special attention to merger and acquisition transactions. Chapter 13 turns to conflicts for corporate control, including hostile tender offers and proxy contexts. And finally, Chapter 14 examines the regulation of transactions in shares on the public markets, including such topics as insider trading and fraud on the market.

While we have structured these materials in a way that conforms to the simple insight that much of corporate law can be divided into general governance, on the one hand, and discrete areas of specialized governance on the other, we expect some teachers will present the materials in a different sequence. We have taken care to facilitate alternative approaches by recapping in later chapters points more exhaustively made in earlier ones and by supplying cross-references for further review.

The book contains a number of notes that are perhaps a bit longer and more openly explanatory than other authors prefer. In this we have been motivated by our experience as teachers to want to provide a rather full textual basis for a general understanding of each subject. Our aim is to provide for those happy occasions when class gets deeply involved in an interesting discussion. In this event we are comforted by the knowledge that we can move on to the next class knowing that all of the basic information and insights have been made available to the class in the reading assignment.

In the end, what makes this branch of law so interesting (and frustrating) to students, practitioners, and scholars alike is the vital role played in it by the open-textured concept of fiduciary duty. From the early study of agency, to its conclusion with corporate mergers and acquisitions, the field and these materials offer myriad puzzles arising from the admixture of morality and efficiency that is often encountered when courts are required to fill in the specifics of a fiduciary’s obligations. In approaching

this subject, the book places primary emphasis on the Delaware statute and decisions, as that law grows in its dominant importance for publicly financed corporations in the United States. Opinions by the Delaware Court of Chancery and the Delaware Supreme Court tend to outnumber cases from other jurisdictions.

The third edition includes developments in corporate law since 2006, including excerpts from recent decisions such as *CA v. AFSCME*, *In re Citigroup*, and *Lyondell Chemical Co. v. Ryan*. The third edition also continues the trend from the second edition of adding citations to the growing empirical literature on corporate law issues, and adding more problems for students to work through. We also include several sidebars throughout the book, which provide vivid real-world illustrations of the topics described in the main text, or background information on the principal players in certain cases. These sidebars can generally be viewed as optional, though often highly entertaining, reading for students. They seek to convey the inherently human element that only occasionally comes to the surface in the judicial opinions themselves. It is our hope that the sidebars will remind students that the law of business organization is about real people, often taking significant financial and personal risks, in an effort to create and distribute wealth in our economy.

We must offer very real thanks and appreciation to colleagues and friends who have taught from these materials for some years and who have been generous in their comments and suggestions. First among these are Victor Brudney, whose teaching materials provided the starting point for this book, and Henry Hansmann, who has commented so richly and so long that it would be difficult to exaggerate our gratitude. Other colleagues have made useful comments and supplied detailed guidance. Among these are Jennifer Arlen, Lucian Bebchuk, Bernard Black, John Coates, Rob Daines, Jill Fisch, Jesse Fried, Jon Hanson, Hon. Jack B. Jacobs, Marcel Kahan, Ehud Kamar, Vic Khanna, Stephen J. Lubben, Mark Roe, and Hon. Leo Strine. We acknowledge gladly our debt to them. We also thank Tim Poulin of the Maine Secretary of State's office for generously sharing his data on new business entity formation. In addition, numerous anonymous reviewers made very helpful comments, and we hope that they will find the book improved because of their efforts. Finally, we each owe a debt of gratitude to student researchers and secretarial associates. Among students, some especially stand out for their glad assistance: Alison Gooley, NYU, 1999, of the Bar of New South Wales; Ronnie Deutch, NYU, 2002, of the New York bar; and Jeffrey Young, HLS, 2010. Special thanks to Melissa Anderson, HLS, 2009, for her excellent work on the sidebars and data collection for the second edition. Susannah Atkins, Cara R. Conlin, Linell Hanover, Barbara Karasinski, Kimberly Peterson, and Paula Prather offered cheerful and highly competent assistance. Our gratitude extends to them all.

William T. Allen
Reinier Kraakman
Guban Subramanian

July 2009

ACKNOWLEDGMENTS

We thank the authors and copyright holders of the following works for permitting their inclusion in this book:

Bebchuk, Kraakman, and Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity*, 295ff. in Randall K. Morck, ed., *Concentrated Corporate Ownership* (2000).

Black, Bernard S., *Next Steps in Proxy Reform*, 18 J. Corp. L. 1, 4-8 (1992).

Coffee, John C., *Business Organization and Finance* (3d ed. 1988), 53-54.

Easterbrook and Fischel, *Corporate Control Transactions*, 91 Yale L.J. 698, 715-719 (1982).

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Eisinger, Jesse, *Long & Short: Icabu Cries Foul at Perry's No-Risk Play in Takeover Fight*, Wall Street Journal, Eastern Edition, Dec. 15, 2004. Copyright 2007 by Dow Jones & Company, Inc. Reproduced with permission of Dow Jones & Company, Inc. in the format Textbook via Copyright Clearance Center.

Hansmann, Kraakman, and Squire, *Law and the Rise of the Firm*, 119 Harv. L. Rev. 1333 (2006).

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**COMMENTARIES AND CASES ON THE LAW
OF BUSINESS ORGANIZATION**

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