

ASPEN CASEBOOK SERIES

*O'KELLEY
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**CORPORATIONS AND OTHER
BUSINESS ASSOCIATIONS**
Cases and Materials

*Seventh
Edition*



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Law & Business

Corporations and Other Business Associations

Cases and Materials

Seventh Edition

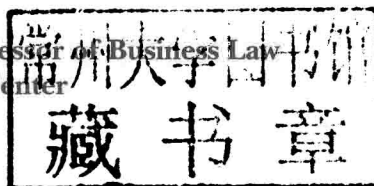
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Preface

This book provides material for the basic course in corporations and other business associations. There is more than one way to teach any course, and the paths multiply for the business associations survey course, in which teachers divide among those who emphasize closely held businesses, those who emphasize the public corporation, and those who spend about the same amount of time on both. This book can be adapted to any one of these approaches with ease. We have structured the chapters so that most topics can be moved and used effectively out of their original order. The book can also be adapted to a one- or two-semester course. Nonetheless, the current organization reflects a coherent combination of material ordered in a way that will be helpful to someone who is approaching corporations and other business associations for the first time.

One of our goals when we began this project more than 25 years ago was to provide a casebook that could grow and change with the subject it addresses while providing continuity to users. Thus, the core structure was designed not to reflect current fancy but rather to illustrate what we believe are central, recurring issues and themes. Each edition, therefore, continues to feel like an old friend to continuing users, though it contains new materials reflective of the constant changes in law, business enterprise, and society. This edition continues that tradition. As with the sixth edition, continuing users will notice new material reflective of our fast evolving securities markets and the relationship of those markets to corporate governance and society. The new millennium has seen two severe shocks to the stock markets: the collapse of the dot-com bubble and the financial meltdown in 2008. The fallout from these financial difficulties has caused some policy makers, lawmakers, and academics to question the extent to which we leave organization of collective business behavior only to markets. Renewed government regulation of executive compensation (e.g., say on pay) and shareholder rights reflect these concerns. At the same time, dramatic changes in the makeup of the market—particularly the growth of share ownership by institutional investors, the expanding role of independent directors, and the rise of activist shareholders—illustrate the vibrancy of private-sector responses. Chapter 3 in particular seeks to capture these recent movements in a context that lets students see how the regulation of publicly held companies is different from that of the closely held enterprise.

The introduction to the corporate form in Chapter 3 can be taught either as a follow-on to Chapter 2 or as a freestanding beginning to the study of the corporate form. In a succinct footprint, the chapter provides the essentials for forming a corporation and includes a business planning exercise for those who wish to pursue experiential learning. At the same time, this chapter provides the necessary overview for students to understand how a publicly held corporation is a different type of business entity. In

turn, this leads to the extensive discussion in Chapter 4 on director and shareholder roles in the corporation.

Any examination of the law of American business enterprises must provide an overview of the interaction of our national and state legal systems. As with many other parts of our national life, the presence of the federal government continues to grow as the law provider in corporate law, a trend exacerbated in the post-Enron, post-financial meltdown environment. In Chapters 10-12 we provide the detail to fill out the initial survey of federal law contained in Chapter 3, including the issue of insider trading, which remains one of the most visible and accessible contexts for viewing the impact of law on corporate behavior. Mergers and other corporate acquisitions provide the most recurring context for federal law covered in this book. In putting most of the federal material after the presentation of the state law structure of these transactions in Chapters 8 and 9, we hope that students will better understand the factual setting and can better evaluate the legal rules.

Despite this growth of federal law, state law (and in particular Delaware law) remains the dominant source for legal rules for corporations. State law reflects a strong preference for private ordering; this law continues to be built around trusting directors to govern corporations and permitting them to make use of a variety of incentives and monitoring devices made available in the private sector and by government regulation. Under this view, the government's role is focused on providing essential background rules and a judicial forum for shareholders to bring fiduciary duties claims as a check on the broad power given directors to control "other people's money." This essentially common law process is visible throughout the book, but Chapter 4 is particularly designed to introduce this theme. It includes materials to cover, for example, narrowing the independent use of good faith and the increasing variety of contexts in which judicial review occurs through special litigation committees.

The seventh edition continues our separate discussion of limited liability companies within what we believe is an innovative chapter. LLCs have been growing since the mid-1990s and now exceed the number of new corporations. The legal principles governing this entity are similar to what students will have seen in earlier parts of the book addressing corporations and partnership. In this chapter we develop a distinctive part of LLC law that is particularly visible in Delaware. That state and its judiciary have focused on legal rules seemingly aimed at sophisticated entities, as contrasted with, for example, the traditional "mom-and-pop" enterprise, whose participants are willing to take the time and pay the costs of developing a specialized template to govern their business relationship. Thus, in Chapter 6 we have picked cases to illustrate the extent to which parties can waive the fiduciary duties provided by law or the ability for investors to seek involuntary dissolution from courts. This in turn reintroduces, in a new context, the question of markets versus government regulation discussed at the beginning of this preface.

Unlike many of the "private" law courses found in the traditional first-year law school curriculum, corporation law does not respond to problems commonly experienced in discrete transactions or interactions between "strangers." Instead, the law of corporations and other business associations addresses the governance of a collective, relational enterprise. For example, the key recurring issue is the ongoing relationship of shareholders to directors and officers, and the extent to which any individual or

group can speak for or direct the enterprise. The corporations or business associations course is many law students' first extended contact with the intricacies of business relationships. Thus, it is especially important to help students grasp new terminology, develop an understanding of what motivates individuals to invest their human or money capital in a cooperative business venture, and recognize how law and private ordering interact to protect participants' reasonable expectations. Economic learning advances the discussion of these issues. An understanding of how markets work and of the incentives that commonly motivate people in economic transactions enriches students' ability to interpret and use the law, so we discuss these concepts in the early chapters. Understanding the economic concepts of "collective action" and "rational apathy" can help to explain why legal rules will be different for an enterprise with many dispersed passive participants than for one with a few close-knit investors.

Although we provide economic-based tools for understanding, the thematic framework of this book is how the law shapes collective business relationships. In the first few chapters, we compare the various forms of doing business: sole proprietorships, partnerships, limited partnerships, limited liability companies, close corporations, and publicly held corporations. A comparative analysis of these forms continues throughout the book in a variety of legal contexts.

We ask students to recognize the various methods used by law to regulate collective business relationships. In examining what legal constraints there should be on the behavior of those who control corporations, a student who has read this book will have considered:

- Voting and other governance rules imposed by law before any transaction has occurred
- Fiduciary duty applied by courts to specific transactions after they have occurred
- Disclosure rules mandating information to be provided in corporate relationships
- Specific legal remedies like appraisals or buyouts

This examination is designed to give students an appreciation for the different ways that law works and the relative advantage of each method as it is applied in particular circumstances, with consideration given to the possible market or private ordering alternatives. Is law supplemental or mandatory? Does it seek to provide the rules that the parties would have agreed to if they had thought carefully about the situation, or does it seek to impose a penalty or an incentive to encourage one side or the other?

At the beginning of each relevant part, section, or subsection, we have noted the statutory or regulatory material to which students should refer when studying that segment. This reflects our view that this material is best studied in close relation to the statutory law. Our comparative approach asks students to think about how the Delaware statute differs from the Model Business Corporation Act, the two most commonly referenced statutory guideposts for corporation law in this country. Referenced statutory and regulatory material appears in the statutory supplement to this book, also published by Wolters Kluwer, which currently includes, for example, new statutory material on benefit corporations and an actual complaint that permits discussion

of judicial review in the Disney cases. Throughout the casebook we use the Model Business Corporation Act to refer to the current version of that Act.

Many case, statutory, and other citations have been omitted from quoted material without indication. Most footnotes have also been omitted from quoted material without indication, but those that remain retain their original numbers. Bracketed material in a quoted source indicates transitional or summary materials that we have provided.

Charles R.T. O'Kelley
Robert B. Thompson

November 2013

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