

ASPEN PUBLISHERS

CHOPER
COFFE
GILSON

Cases and Materials on
CORPORATIONS

*Seventh
Edition*



Wolters Kluwer

Law & Business

**Cases
and Materials
on Corporations**

EDITORIAL ADVISORS

Vicki Been

Elihu Root Professor of Law
New York University School of Law

Erwin Chemerinsky

Alston & Bird Professor of Law
Duke University School of Law

Richard A. Epstein

James Parker Hall Distinguished Service Professor of Law
University of Chicago Law School
Peter and Kirsten Bedford Senior Fellow
The Hoover Institution
Stanford University

Ronald J. Gilson

Charles J. Meyers Professor of Law and Business
Stanford University
Marc and Eva Stern Professor of Law and Business
Columbia Law School

James E. Krier

Earl Warren DeLano Professor of Law
The University of Michigan Law School

Richard K. Neumann, Jr.

Professor of Law
Hofstra University School of Law

Robert H. Sitkoff

John L. Gray Professor of Law
Harvard Law School

David Alan Sklansky

Professor of Law
University of California at Berkeley School of Law

Kent D. Syverud

Dean and Ethan A. H. Shepley University Professor
Washington University School of Law

Elizabeth Warren

Leo Gottlieb Professor of Law
Harvard Law School

ASPEN PUBLISHERS

Cases and Materials on Corporations

SEVENTH EDITION

Jesse H. Choper

University of California at Berkeley

John C. Coffee, Jr.

Columbia University

Ronald J. Gilson

*Columbia University and
Stanford University*



Wolters Kluwer

Law & Business

AUSTIN BOSTON CHICAGO NEW YORK THE NETHERLANDS

© 2008 Jesse H. Choper, John C. Coffee, and Ronald J. Gilson.

Published by Aspen Publishers. All Rights Reserved.

No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or any information storage and retrieval system, without permission in writing from the publisher. Requests for permission to make copies of any part of this publication should be mailed to:

Aspen Publishers
Attn: Permissions Department
76 Ninth Avenue, 7th Floor
New York, NY 10011-5201

To contact Customer Care, e-mail customer.care@aspenpublishers.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

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

Printed in the United States of America

1 2 3 4 5 6 7 8 9 0

ISBN 978-0-7355-7034-4

Library of Congress Cataloging-in-Publication Data

Choper, Jesse H.

Cases and materials on corporations / Jesse H. Choper, John C. Coffee, Jr., Ronald J. Gilson. — 7th ed.

p. cm.

Includes index.

ISBN 978-0-7355-7034-4 (casebound : alk. paper)

1. Corporation law — United States — Cases. I. Coffee, John C., 1944- II. Gilson, Ronald J., 1946- III. Title.

KF1414.F694 2008
346. 73' 066 — dc22

2008007609

About Wolters Kluwer Law & Business

Wolters Kluwer Law & Business is a leading provider of research information and workflow solutions in key specialty areas. The strengths of the individual brands of Aspen Publishers, CCH, Kluwer Law International and Loislaw are aligned within Wolters Kluwer Law & Business to provide comprehensive, in-depth solutions and expert-authored content for the legal, professional and education markets.

CCH was founded in 1913 and has served more than four generations of business professionals and their clients. The CCH products in the Wolters Kluwer Law & Business group are highly regarded electronic and print resources for legal, securities, antitrust and trade regulation, government contracting, banking, pension, payroll, employment and labor, and healthcare reimbursement and compliance professionals.

Aspen Publishers is a leading information provider for attorneys, business professionals and law students. Written by preeminent authorities, Aspen products offer analytical and practical information in a range of specialty practice areas from securities law and intellectual property to mergers and acquisitions and pension/benefits. Aspen's trusted legal education resources provide professors and students with high-quality, up-to-date and effective resources for successful instruction and study in all areas of the law.

Kluwer Law International supplies the global business community with comprehensive English-language international legal information. Legal practitioners, corporate counsel and business executives around the world rely on the Kluwer Law International journals, loose-leafs, books and electronic products for authoritative information in many areas of international legal practice.

Loislaw is a premier provider of digitized legal content to small law firm practitioners of various specializations. Loislaw provides attorneys with the ability to quickly and efficiently find the necessary legal information they need, when and where they need it, by facilitating access to primary law as well as state-specific law, records, forms and treatises.

Wolters Kluwer Law & Business, a unit of Wolters Kluwer, is headquartered in New York and Riverwoods, Illinois. Wolters Kluwer is a leading multinational publisher and information services company.

SUMMARY OF CONTENTS

<i>Contents</i>	<i>ix</i>
<i>Preface</i>	<i>xxv</i>
<i>Acknowledgments</i>	<i>xxvii</i>
 I. INTRODUCTION	 1
 II. BASIC NORMS AND DUTIES FOR MANAGEMENT OF CORPORATIONS	 55
 III. AN INTRODUCTION TO CORPORATE FINANCE	 177
 IV. FORMING THE CORPORATION	 233
 V. CORPORATE DISCLOSURE AND SECURITIES FRAUD	 299
 VI. VOTING AND CORPORATE CONTROL	 541
	vii

VII.	BUSINESS ORGANIZATION FOR THE SMALLER ENTERPRISE: PARTNERSHIPS, CLOSE CORPORATIONS, LIMITED LIABILITY COMPANIES, AND OTHER NON-CORPORATE FORMS	703
VIII.	SHAREHOLDERS' SUITS	825
IX.	CORPORATE ACQUISITIONS, TAKEOVERS, AND CONTROL TRANSACTIONS	937
	<i>Table of Cases</i>	1149
	<i>Table of Statutes</i>	1167
	<i>Index</i>	1181

CONTENTS

Preface

xxv

Acknowledgments

xxvii

I. INTRODUCTION	1
A. The Legal Character of the Corporation: Factors Influencing Choice of the Corporate Form	1
B. An Overview of This Casebook	3
C. A Scorecard of the Players: Public Corporations, Managers, Directors, and Shareholders	4
1. A Corporate Census	4
2. The Individual Participants	5
D. History and Evolution of the Business Corporation	17
1. The Early American Experience	18
Lawrence Friedman, A History of American Law	18
2. Nineteenth-Century Efforts to Control the Corporation	22
Lawrence Friedman, A History of American Law	22
3. Twentieth-Century Developments	25
a. The "Race to the Bottom" Thesis	25
b. The Rise of Managerial Capitalism	27
E. Economic Analysis of the Corporation	29
1. The Nature of the Firm and the Rise of the M-Form Corporation	29
2. Managerial Discretion: The Debate over the Berle-Means Thesis	30
3. The Agency Cost Model	32

F. The Social Responsibility of the Corporation	34
1. To Whom Do Fiduciary Duties Run?	34
E. Merrick Dodd, For Whom Are Corporate Managers Trustees?	35
Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits	36
<i>American Law Institute, Principles of Corporate Governance—Objective and Conduct of the Corporation</i>	37
2. The Rise of Corporate Constituency Statutes	40
<i>New York Business Corporation Law—Duty of Directors</i>	41
<i>Connecticut Business Corporation Law—Board of Directors</i>	42
3. Objections to Constituency Statutes	42
<i>American Bar Association Committee on Corporate Laws, Report: Other Constituencies Statutes: Potential for Confusion</i>	43
4. The Case for Constituency Statutes	45
5. The Judicial Development of Non-Shareholder Fiduciary Duties	46
G. The Global Perspective	48

II. BASIC NORMS AND DUTIES FOR MANAGEMENT OF CORPORATIONS 55

A. Transaction of Corporate Business	55
1. Introduction	55
<i>Revised Model Business Corporation Act—Duties of Board of Directors</i>	56
2. Directors	57
a. Formalities Required	57
<i>Revised Model Business Corporation Act—Meetings</i>	57
b. Effect of Failure to Follow Requirements	58
3. Officers	59
a. Authority	59
<i>Menard, Inc. v. Dage-MTI, Inc.</i>	59
b. Ultra Vires Doctrine	67
<i>Real Estate Capital Corp. v. Thunder Corp.</i>	68
<i>Ohio General Corporation Law—Authority of Corporation</i>	72
<i>Revised Model Business Corporation Act—Ultra Vires</i>	72
B. Managers' Responsibilities and Compensation	73
1. Introduction	73

2. Disinterested Conduct: Duty of Care	73
<i>Shlensky v. Wrigley</i>	75
<i>Miller v. American Telephone & Telegraph Co.</i>	78
<i>Francis v. United Jersey Bank</i>	82
<i>Smith v. Van Gorkom</i>	84
<i>In re Walt Disney Co. Derivative</i>	
Litigation	88
<i>In re Caremark Int'l, Inc. Derivative Litigation</i>	97
<i>Stone v. Ritter</i>	99
American Law Institute, Principles of Corporate	
Governance—Duty of Care; Business	
Judgment Rule	103
<i>Joy v. North</i>	106
3. Transactions in Which Directors, Officers, and	
Shareholders Have a Personal Interest: Duty of Loyalty	110
a. Contracts with Interested Directors	111
<i>Cookies Food Products, Inc. v. Lakes Warehouse</i>	
<i>Distributing, Inc.</i>	112
New York Business Corporation Law—Interested	
Directors	119
California General Corporation Law—	
Contracts in Which Director Has Financial	
Interest	120
American Law Institute, Principles of Corporate	
Governance—Transactions with the	
Corporation	120
b. Special Problems of Parent-Subsidiary	128
<i>Case v. New York Central R.R.</i>	128
<i>Sinclair Oil Corp. v. Levien</i>	131
c. Compensation of Managers	136
i. Salaries, Bonuses, Pensions	137
<i>Adams v. Smith</i>	138
<i>Osborne v. Locke Steel Chain Co.</i>	139
<i>Mlinarcik v. E.E. Wehrung Parking, Inc.</i>	142
ii. Stock Options	148
New Mexico Business Corporation Act—Stock	
Options	150
<i>Eliasberg v. Standard Oil Co.</i>	150
<i>Beard v. Elster</i>	154
d. Corporate Opportunities and Competition with the	
Corporation	161
<i>Irving Trust Co. v. Deutsch</i>	161
<i>Rapistan Corp. v. Michaels</i>	167
<i>Burg v. Horn</i>	170
<i>Alexander & Alexander of N.Y., Inc. v. Fritzen</i>	172
American Law Institute, Principles of Corporate	
Governance—Taking of Corporate	
Opportunities	174

III. AN INTRODUCTION TO CORPORATE FINANCE	177
A. Valuation: How Are Financial Assets Valued?	179
1. Valuation Under Certainty: Present Value and the Time Value of Money	179
William A. Klein & John C. Coffee Jr., Business Organization and Finance	179
2. Valuation Under Uncertainty: Risk and Diversification	183
a. Expected Value	184
b. Risk	184
c. Diversification	187
d. The Capital Asset Pricing Model	189
3. The Efficient Capital Market Hypothesis	192
<i>Kamin v. American Express Company</i>	198
B. Capital Structure: Does the Ownership Structure of a Corporation Affect Its Value?	199
1. A Survey of Financial Assets	200
a. Common Stock	200
b. Debt	201
c. Preferred Stock	202
d. Warrants	202
e. Hybrid Financial Assets	203
2. Why Capital Structure Should Not Affect the Value of the Corporation: The Miller-Modigliani Irrelevance Proposition	204
3. Why Capital Structure May Affect Firm Value	206
a. Taxes	206
b. The Information Content of Capital Structure	207
c. The Disciplinary Effect of Debt	208
d. Bankruptcy Costs	210
C. Opportunism Among the Holders of Financial Claims: Option Pricing	211
1. The Basic Structure of Put and Call Options	212
2. The Determinants of Option Value	213
a. Current Value of the Underlying Asset	214
b. The Exercise Price	214
c. The Time Value of Money	214
d. Variability in the Value of the Underlying Asset	214
e. Time Remaining Until Expiration	216
3. Modes of Opportunistic Behavior Among Holders of Financial Assets	216
a. Increasing the Riskiness of the Corporation's Investments	216
b. Increasing the Firm's Leverage by Withdrawing Funds	218
c. Increasing the Value of the Option by Extending Its Term	219

D. Protection Against Intracorporate Opportunism	219
1. Weak Protection: The Statutory Legal Capital Structure	220
2. Fraudulent Conveyance Law	224
3. Contractual Protection: Bond Covenants	225
a. Investment Activity Covenants	225
b. Capital Structure Covenants	226
c. Dividend and Stock Repurchase Covenants	226
4. Fiduciary Duty and the Covenant of Good Faith and Fair Dealing	228
<i>Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.</i>	230

IV. FORMING THE CORPORATION **233**

A. Selection of State of Incorporation	233
B. Compliance with State Requirements	238
1. Preparation of Documents	238
<i>Delaware General Corporation Law—How Corporation Formed</i>	238
2. Meeting Statutory Formalities	240
3. "Domestication" of Foreign Corporations	241
C. Defective Incorporation	241
<i>Thompson & Green Machinery Co. v. Music City Lumber Co.</i>	243
<i>Don Swann Sales Corp. v. Echols</i>	246
<i>Delaware General Corporation Law—Defective Organization as a Defense</i>	248
<i>Revised Model Business Corporation Act—Liability for Preincorporation Transactions</i>	248
<i>Sulphur Export Corp. v. Carribean Clipper Lines, Inc.</i>	249
<i>Ohio General Corporation Law—Liability for Nonpayment of Stated Capital</i>	250
D. Disregarding the Corporate Entity	251
<i>Perpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.</i>	253
<i>Kinney Shoe Corp. v. Polan</i>	256
<i>Texas Business Corporation Act—Liability of Shareholders</i>	261
<i>Walkovsky v. Carlton</i>	261
<i>Fletcher v. Atex, Inc.</i>	266
<i>Bartle v. Home Owners Cooperative</i>	275
<i>Stone v. Eacho</i>	277
E. Pre-Formation Transactions	281
1. Liability of the Corporation for Debts of Its Predecessor	281
<i>Tift v. Forage King Industries, Inc.</i>	282
<i>J. F. Anderson Lumber Co. v. Myers</i>	285
<i>Kulka v. Nemirovsky</i>	287

2. Promoters' Contracts	288
a. Introduction	288
b. Liability of the Corporation	290
<i>Kridelbaugh v. Aldrehn Theatres Co.</i>	290
c. Liability of the Promoters	292
<i>Sherwood & Roberts—Oregon, Inc. v. Alexander</i>	292
<i>How & Associates, Inc. v. Boss</i>	294
<i>Stewart Realty Co. v. Keller</i>	296

V. CORPORATE DISCLOSURE AND SECURITIES FRAUD 299

A. Introduction	299
B. The Disclosure System	300
1. The Securities Act of 1933	301
2. The Securities Exchange Act of 1934	302
3. "Blue Sky" Regulation	304
4. Disclosure Requirements of Self-Regulatory Organizations	305
New York Stock Exchange Listed Company Manual	306
5. When Does the Disclosure Obligation Arise?	307
<i>Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.</i>	308
<i>Basic, Inc. v. Levinson</i>	312
<i>Backman v. Polaroid Corp.</i>	318
<i>In re Time Warner Securities Litigation</i>	322
6. Reforming the Disclosure System: The Sarbanes-Oxley Act of 2002	326
a. The Public Company Accounting Oversight Board	327
b. Auditor Independence	329
c. Corporate Governance	330
d. Improved Financial Disclosures	332
e. SEC Authority over Attorneys	333
f. What Remains?	333
C. Civil Liability	334
1. Common Law Remedies	335
2. Blue Sky Statutes	336
3. The Fiduciary Duty of Disclosure	336
<i>Malone v. Brincat</i>	336
4. Federal Law: Express Actions	342
<i>Securities Act of 1933, Section 11</i>	342
<i>Securities Act of 1933, Section 12</i>	343
5. Federal Law: Implied Civil Liabilities	344
a. The Origin of Rule 10b-5	344
<i>Securities Exchange Act of 1934, Section 10b-5</i>	344
	345

b.	The Rationale and Scope of Implied Liabilities	345
	<i>J. I. Case Co. v. Borak</i>	346
	<i>Piper v. Chris-Craft Industries, Inc.</i>	349
	<i>Touche Ross & Co. v. Redington</i>	351
	<i>Herman & MacLean v. Huddleston</i>	352
c.	The Elements of a Cause of Action Under Rule 10b-5	353
	i. Standing Under Rule 10b-5: Limiting the Plaintiff Class	353
	<i>Blue Chip Stamps v. Manor Dug Stores</i>	353
	<i>SEC v. Zanford</i>	366
	<i>Wharf (Holdings) Ltd. V. United Int'l Holdings, Inc.</i>	367
	<i>Small v. Fritz Cos.</i>	368
	<i>Merrill Lynch, Pierce, Fenner & Smith v. Dabit</i>	368
	ii. Materiality	369
	<i>SEC v. Texas Gulf Sulphur Co.</i>	369
	<i>TSC Industries, Inc. v. Northway, Inc.</i>	372
	<i>Virginia Bankshares, Inc. v. Sandberg</i>	374
	<i>In re Donald Trump Casino Securities Litigation</i>	378
	<i>Private Securities Litigation Reform Act of 1995</i>	381
	iii. Causation	382
	<i>Affiliated Ute Citizens v. United States</i>	382
	<i>Basic, Inc. v. Levinson</i>	384
	<i>Dura Pharmaceuticals, Inc. v. Michael Broudo</i>	391
	iv. Scienter	396
	<i>Ernst & Ernst v. Hochfelder</i>	396
	<i>Aaron v. SEC</i>	403
	<i>Tellabs, Inc. v. Makor Issues & Rights, Ltd.</i>	404
	v. Damages	412
	<i>Mitchell v. Texas Gulf Sulphur Co.</i>	412
	vi. Statute of Limitations Applicable to Rule 10b-5	422
	vii. Contribution	422
d.	The Policy Dilemma Surrounding Securities Class Actions	423
	The Empirical Evidence: A Complex Thicket	424
e.	The Response of the Private Securities Litigation Reform Act of 1995	426
f.	The Impact of the 1995 Act	428
g.	Transactions Not Covered by the Rule	429
	i. Corporate Mismanagement	429
	<i>Superintendent of Insurance v. Bankers Life & Casualty Co.</i>	429
	<i>Santa Fe Industries, Inc. v. Green</i>	432
	<i>Goldberg v. Meridor</i>	437
	ii. Aiding and Abetting	440
	<i>Central Bank of Denver v. First Interstate Bank of Denver</i>	440

D. Insider Trading	446
1. Rule 10b-5 and Insider Trading	446
a. The Rationale and Scope of the Prohibition	446
<i>In the Matter of Cady, Roberts & Co.</i>	446
b. The Harms from Insider Trading	449
i. Corporate Harm	449
ii. Allocational Efficiency and the Injury of Delayed Disclosure	450
iii. Investor Injury	450
c. The "Benefits" of Insider Trading	452
d. The Enforceability of the Prohibition	453
<i>Dirks v. SEC</i>	454
e. Selective Disclosure and Regulation FD	466
<i>Regulation FD, Section 100</i>	467
f. Misappropriation Theory	470
<i>United States v. O'Hagan</i>	470
<i>Rule 10b5-1</i>	486
g. Insider Trading and the Remote Tippee	488
<i>United States v. Chestman</i>	488
<i>Rule 10b5-2</i>	497
h. Causation and Damages in Insider Trading Cases	497
<i>Securities Exchange Act of 1934, Section 20A</i>	498
<i>Elkind v. Liggett & Myers, Inc.</i>	499
<i>Insider Trading Sanctions Act of 1984</i>	502
2. Section 16(b) and "Short Swing" Profits	505
<i>Securities Exchange Act of 1934, Section 16</i>	505
a. Who Is Covered?	506
<i>Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston</i>	506
<i>CBI Industries, Inc. v. Horton</i>	508
<i>Reliance Electric Co. v. Emerson Electric Co.</i>	511
<i>Foremost-McKesson, Inc. v. Provident Securities Co.</i>	514
<i>Chemical Fund, Inc. v. Xerox Corp.</i>	517
<i>Smolowe v. Delendo</i>	518
b. The Definition of "Purchase or Sale"	520
<i>Kern County Land Co. v. Occidental Petroleum Corp.</i>	520
3. Common Law Liability to the Corporation	529
<i>Diamond v. Oreamuno</i>	529
<i>Freeman v. Decio</i>	534
<i>Walton v. Morgan Stanley & Co.</i>	539

VI. VOTING AND CORPORATE CONTROL 541

A. Overview: Voting and "Shareholder Democracy"	541
B. The Substantive Law of Shareholder Voting	548