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New Perspectives in Corporate Law

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NEW PERSPECTIVES IN CORPORATE LAW

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NEW PERSPECTIVES IN CORPORATE LAW

ASAF RAZ[*]

INTRODUCTION

"The life of the law has not been logic: it has been experience,"[1] wrote Oliver Wendell Holmes in 1881, laying the foundation for what would become the legal realist movement, and subsequently much of the way we think about, practice, adjudicate, and study the law today. Yet what if the life of the law has been *both* logic and experience? What if the law has its own structure, taxonomy, and unwaivable principles, which in turn operate to make the world a better place, even in extra-legal terms (economic, social, or otherwise)? This debate, regarding the proper balance between internal and external perspectives on the law, continues to unfold today. In my dissertation—consisting of this Introduction and my first,[2] second,[3] and third[4] scholarly articles—I have set out to bridge the internal and external viewpoints on an area of jurisprudence that, so far, has largely remained on the realist side of the spectrum: corporate law.

This Introduction describes the path I took while writing my dissertation, explaining the motivation for each article, how it relates to the others, and what lessons I hope can be derived from the dissertation as a whole.

A. *Why Do Legal Categories Have Value?*

The idea of share law, which lies at the center of my first article,[5] occurred to me some years before I came to the University of Pennsylvania. As

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[1] OLIVER WENDELL HOLMES, JR., THE COMMON LAW 3 (Harvard Univ. Press 2009) (1881).

[2] Asaf Raz, *Share Law: Toward a New Understanding of Corporate Law*, 40 U. PA. J. INT'L L. 255 (2018).

[3] Asaf Raz, *A Purpose-Based Theory of Corporate Law*, 65 VILL. L. REV. 523 (2020).

[4] Asaf Raz, *Mandatory Arbitration and the Boundaries of Corporate Law*, 29 GEO. MASON L. REV. (forthcoming 2021).

[5] Raz, *supra* note 2.

an aspiring academic, and an avid reader of legal cases and scholarship, I often thought about questions such as: who should be the parties to this lawsuit? Who holds what kind of cause of action? More broadly, where do we find the *legal norm* that tells us what rights and duties people have in a given situation—and which people have them? In most cases, that inquiry is not overly difficult; although it is sometimes hard to distill the norm itself, we generally know where to look for it. Contract law governs the rights and duties of contract parties (and, because this legal framework exists, contracts have economic value). Constitutional law constrains the legislature, and other state branches, vis-à-vis the people. We would normally not think to conflate the two, just as we would not confuse contract with, say, property or tort law, or these two among themselves. Indeed, even the most ardent legal realists[6] saw the significance in Professor Wesley Hohfeld's classic taxonomy of rights and duties.[7]

Yet, in regard to one kind of situation—that of *shareholders*—I found it much harder to discern both the substance and the parties. As I soon realized, that difficulty was shared by the broader legal community. Despite the fact that the value of publicly-traded shares worldwide is in the tens of trillions of U.S. dollars,[8] shareholders fit like a square peg into the round hole of conventional legal categories: as my first article demonstrates, shareholders are not contract parties, given the near-total lack of ex ante information about any promise owed to them;[9] they are not covered by property law, for it is not clear what "owning" a corporation practically means, nor do shareholders own the corporation's buildings, trademarks, or bank accounts (the corporation does);[10] they cannot be regarded as trust beneficiaries;[11] and, despite seemingly pervasive judicial language in some U.S. jurisdictions, shareholders (outside of "a limited set of circumstances"[12]) are not direct beneficiaries of *the corporation's*

[6] *See, e.g.*, Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 828 (1935) (favorably referring to Hohfeld's ideas).

[7] Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913).

[8] *See Stocks Traded, Total Value (Current US$)*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.TRAD.CD [https://perma.cc/QVF6-U8HN] (last visited Apr. 2, 2021) (indicating that the total value of shares publicly traded worldwide, in 2019, was US$60.359 trillion).

[9] *See* Raz, *supra* note 2, at 282-85.

[10] *See id.* at 285-87.

[11] *See id.* at 287-90.

[12] Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989).

fiduciaries (such as directors and officers).[13] As a result, shareholders cannot even be described as creatures of corporate law generally; their rights derive from a certain *segment* of corporate law, different than that which regulates the relationship between the corporation and its fiduciaries.

What legal norms govern shares, then? In other words, *why do shares have value?* It was with this question that I set out to write my first article. The solution I fashioned was straightforward: shares reside in their own legal category. Within corporate law, we can identify a set of rules and principles that apply where a person is a *residual claimant*—having an entitlement defined only as "what is left after the corporation meets all of its *other* obligations."[14] I call that set of rules and principles "share law." Because shareholders, as residual claimants, encounter a unique array of problems (mainly resulting from the open-ended, practically unlimited range of situations they might find themselves in),[15] the law responds with a set of devices—among them the appraisal remedy, the law of share dilution, dividends and buybacks, shareholder voting, books and records inspection, and shareholder litigation[16]—tailored to ensure shareholders have a fair opportunity to receive the fruits of their bargain (even if the economic substance of those fruits changes on a constant basis).

Just as the rest of corporate law does not float in mid-air, but borrows from other legal traditions (although it often re-assembles them in a unique manner), share law primarily rests on concepts of *equity*. It is the sensitivity of shareholders' legal position, which can easily (and sometimes invisibly) be frustrated by their main counterparty (the corporation) or by others (such as directors, officers, and fellow shareholders), that justifies reliance on the anti-

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[13] *See* Raz, *supra* note 2, at 290-301.

[14] This is the defining property of residual claims. If a person has some claim that arises under any other legal mechanism, it is not residual by nature. *See* Leo E. Strine, Jr., *Poor Pitiful or Potently Powerful Preferred?*, 161 U. PA. L. REV. 2025, 2040 (2013) ("To the extent the preferred get a contract right, they are preferred. To the extent they do not, they are subject to the same risks as other stockholders and entitled to no extra value or rights."). The definition of residual claims, as subordinated to all of the corporation's other legal obligations, also has strong bearing on broader debates in corporate law, and helps chart a more accurate way between the two prevailing conceptions (shareholderism and stakeholderism). *See infra* pp. 10-13.

[15] *See, e.g.*, *id.* at 263-69 (discussing a case where some of the corporation's shareholders could not be located, so the court was asked to decide whether to distribute their dividend—about US$5,700 per claimant—among the other shareholders); Raz, *supra* note 4, at 54 n.309 (describing other highly unusual situations involving shareholders, litigated in the Delaware Court of Chancery).

[16] *See* Raz, *supra* note 2, at 311-19.

opportunistic power of equity.[17] Although the terms are sometimes used interchangeably by U.S. corporate lawyers, equity is not the same as fiduciary law; the latter is but one branch of equity.[18] About a year after my first article was published, I was happy to see this distinction further developed, in extensive detail, by Professor Paul Miller.[19] The oppression remedy, discussed in Miller's article, and grounded in equitable (rather than fiduciary) principles, sits at the heart of share law in Commonwealth and other jurisdictions.

In several places throughout my first article, I discuss the prominent role played by the concept of *corporate purpose*.[20] It is there that the foundations have been laid for my next article.

B. *Taking the Corporation Seriously*

My second article[21] came as a result of several insights I gained during 2018-2020, while participating in the dynamic environment of corporate and business law, which I was fortunate to experience at Penn Law. In discussions with professors, practitioners, judges, and others—and while reading scholarly articles and other resources—I noticed a curious pattern, which I call the "blanket pulling problem":[22] it is often the case that members of the legal community recognize most of corporate law's underlying principles, and yet do not fully observe at least one crucial component.

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[17] *See, e.g.*, Henry E. Smith, *Equity as Meta-Law*, 130 YALE L.J. 1050 (2021) (discussing equity's role in dealing with the problem of opportunism). Note that equity is not *only* about anti-opportunism: for example, the practice of "equitable interpretation" is a response available to judges to deal with a situation where "lay legislatures, out of ignorance, inattention, or democratic zeal, enact statutes that threaten the working structure of specific areas of law or contravene deep-rooted rule of law principles." Farah Peterson, *Interpretation as Statecraft: Chancellor Kent and the Collaborative Era of American Statutory Interpretation*, 77 MD. L. REV. 712, 712 & *passim* (2018).

[18] *See, e.g.*, Henry E Smith, *Why Fiduciary Law Is Equitable*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 261, 261 (Andrew S Gold & Paul B Miller eds., 2014) ("Fiduciary law is an outgrowth of equity—perhaps the most important and characteristic branch of the tree of equity . . . .").

[19] Paul B. Miller, *Equity, Majoritarian Governance, and the Oppression Remedy*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur B. Laby & Jacob Hale Russell eds., forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3483563 [https://perma.cc/T3MD-LBNV].

[20] *See* Raz, *supra* note 2, at 291 n.142, 293, 294 n.152, 318-19, 321.

[21] Raz, *supra* note 3.

[22] *See id.* at 526, 533 & n.49.

For example, in a 2019 article,[23] Professor Jonathan Macey and Chief Justice Leo Strine correctly emphasize the importance of corporate personhood;[24] at the same time, they argue that "shareholders are . . . merely owners of investment contracts that give them certain contractual claims on the cash flows generated by the corporation,"[25] despite the fact that residual claims are inherently *uncertain*, and the concomitant role of equity.[26] Similarly, in a 2020 article,[27] Professor Ann Lipton elaborates on the corporation's fundamental duty to obey the law, but minimizes corporate personhood—for instance, by saying that "[c]ompanies do not act; individuals within them do."[28] The authors' valuable arguments would not be diminished—and might actually be reinforced—if they acknowledged the missing building block; but it is missing nonetheless.

The blanket pulling problem even extends to the most significant faultline in modern corporate law: the debate between the "shareholderist" and "stakeholderist" conceptions, which are seen as dichotomous, and often perceived as the only two options.[29] While shareholderists argue that the corporation's purpose is, and should be, the pursuit of profit, they mostly sweep aside the corporation's entity status (and sometimes, ironically,[30] the unwaivable norms of equity and fiduciary duty). Stakeholderists, on the other hand, correctly point out that the corporation is a legal person, separate from its shareholders—and at the same time, do not admit it should be permissible for that entity to pursue profit, even if it does so in full accordance with law; instead, an extra layer of non-clearly-defined obligation to promote "corporate

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[23] Jonathan Macey & Leo E. Strine, Jr., Citizens United *as Bad Corporate Law*, 2019 WIS. L. REV. 451.

[24] *See id.* at 458-77.

[25] *Id.* at 483.

[26] *See, e.g.*, Miller, *supra* note 19; Raz, *supra* note 2.

[27] Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657.

[28] *Id.* at 661.

[29] *See, e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 *passim* (contrasting the "property conception" (shareholderism) with the "entity conception" (stakeholderism)); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 773 (2015) (stating that in his article, "Chancellor Allen dilated on the two major traditions in American corporate law").

[30] *See* Raz, *supra* note 4, at 59-62.

social responsibility" should attach to corporations. Two months after I presented my second article at the National Business Law Scholars Conference at UC Berkeley School of Law, the shareholderist-stakeholderist debate again took center stage (in terms of both public and scholarly attention), with the Business Roundtable's statement on corporate purpose.[31] It has remained there since.

When the blanket is pulled this way, someone will always be left in the cold: the corporate entity, stakeholders, or shareholders. I realized that it was possible, and now vital, to formulate a theory of corporate law that covers all bases. Such theory should both have good *predictive* power (in terms of adhering, better than existing theories, to real-life observations on the operation of corporate law), and respond to the *normative* concerns of shareholderists and stakeholderists alike. This is the purpose-based theory of corporate law.

As my second article explains, the core property of the corporation is that it is a *person with a purpose*. The concept of corporate personhood is not always easy to fathom, as exemplified by the public response to the *Citizens United*[32] and *Hobby Lobby*[33] decisions (ironically so, since the Supreme Court in these cases largely *ignored* corporate personhood),[34] and by many scholars' preference for saying that the corporation is a "nexus of contracts,"[35] or just an aggregate of something else (people, assets, or rights). Yet, as I detail in the article,[36] every corporation is one, single entity, having its own Hohfeldian relationships with other people. This is true both descriptively and normatively: corporate personhood is a defining, practically important, and highly beneficial phenomenon in corporate law.[37]

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[31] *See* Raz, *supra* note 3, at 528 n.15.

[32] Citizens United v. FEC, 558 U.S. 310 (2010).

[33] Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682 (2014).

[34] *See, e.g.*, ADAM WINKLER, WE THE CORPORATIONS 364 (2018) ("Corporate personhood . . . is entirely missing from the [*Citizens United*] opinion. . . . [T]he *Citizens United* decision obscured the corporate entity and emphasized the rights of others, like shareholders and listeners."); Raz, *supra* note 3, at 571.

[35] *See, e.g.*, Raz, *supra* note 4, at 4 n.15 and accompanying text.

[36] *See* Raz, *supra* note 3, at 539-48.

[37] *See, e.g.*, Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003); Lynn A. Stout, *The Corporation As a Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form*, 38 SEATTLE U. L. REV. 685 (2015). As I note in my second article, *see* Raz,

Although corporate personhood has (and should have) a wider range of ramifications than many currently admit, we must not forget that corporations—like law itself—*ultimately* exist to make the world a better place for humans.[38] The legal concept of corporate purpose[39] serves as the glue that binds the corporation with other members of society. The corporation's purpose shapes its legal interactions in three principal ways: first, the purpose must always be *lawful* (for example, the lawful pursuit of profit); the corporation is obliged to meet all of its obligations to stakeholders (or non-residual claimants), arising under any area of law, without exception.[40] Second, the remaining part of the corporation's purpose—such as "the pursuit of profit" (or any other, as in the case of nonprofit corporations)—generates the value of residual claimants' rights,[41] albeit only indirectly.[42] Third, the corporation's fiduciaries (among them directors, officers, controlling shareholders, and in some cases activist shareholders[43]) are obliged, by their duty of loyalty, to cause the corporation to achieve its purpose.[44] As four leading Delaware jurists have written, "the director's job demands affirmative action—to protect and to better the position of the corporation."[45]

As I argue, corporate law therefore has a total of five structural, unwaivable building blocks: two properties inherent to the corporation itself (its purpose and personhood), and three relationships in which it engages, with certain legal norms attaching to each (the duty of obedience in regard to stakeholders; the equitable rights of residual claimants; and the fiduciary duties owed by fiduciaries). These building blocks are "not subject to private ordering;

supra note 3, at 543-44, a classic work in law and economics, R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937), also underscores the role of corporate personhood.

[38] *See, e.g.*, Elizabeth Pollman, *Reconceiving Corporate Personhood*, 2011 UTAH L. REV. 1629, 1663 ("[W]e owe no allegiance to corporations . . . without reference to the idea that people are involved.").

[39] *See* Raz, *supra* note 3, at 533-39.

[40] *See id.* at 548-57.

[41] *See id.* at 562 (discussing the link between share law and the law of corporate purpose).

[42] *See id.* at 538-39, 561.

[43] *See, e.g.*, *id.* at 567-70.

[44] *See id.* at 563-66.

[45] Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 636 (2010).

[they are] the foundation *upon which* contracting occurs."[46]

Hyper-contractarians might balk at even these five requirements, but this is a fairly *minimalist* account of corporate law's mandatory structure. For instance, when no separate entity is present, by definition there cannot be limited liability, or asset partitioning, which we take for granted as associated with a "corporation."[47] Nor is it clear why should the law permit a waiver of fiduciary duties (at least the "core"[48] thereof), as no manager can possibly expect to be legally entitled to harm the corporation, or expropriate its assets (just as lawyers cannot possibly expect to have a legal right to act against their own client, even if the client signed a "contract" supposedly allowing that).[49]

While the second and third relationships (corporation-shareholder and corporation-fiduciary) are subject to fairly extensive scholarly attention, here I would like to expand on the first one: the corporation's relationship with its stakeholders, centered on the corporation's omnipresent duty of legal obedience. Improving our understanding in this area is critical for charting a better course for corporate law, moving away from the two prevailing, but inaccurate, conceptions (shareholderism and stakeholderism), as I started to suggest in my second article. In the next several paragraphs, I offer a direction for further study, based on insights from my dissertation.

The corporation's duty to obey the law—and the legal system's response when that duty is breached—has several distinct foundations. First,

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[46] Raz, *supra* note 3, at 530.

[47] *See, e.g.*, REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 5-8 (3d ed. 2017) (discussing "[l]egal personality" as a "core structural characteristic[]" of the corporation); Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000) ("[O]rganizational law . . . provide[s] for the creation of . . . 'asset partitioning' that could not practicably be established [without organizational law].").

[48] Amir N. Licht, *Motivation, Information, Negotiation: Why Fiduciary Accountability Cannot Be Negotiable*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 159, 179 (D. Gordon Smith & Andrew S. Gold eds., 2018) ("Fiduciary law . . . preserves an irreducible core of accountability to ensure fiduciary loyalty.").

[49] This is related to another argument I make in my second article: that the limited liability company (LLC) is functionally identical to a corporation (in the narrow sense of the word, used in the U.S. for historical reasons), as both have these exact same building blocks—and therefore, laws "permitting" the waiver of fiduciary duties owed to LLCs are misguided and inequitable. *See* Raz, *supra* note 3, at 573-81. While it is clear that U.S. law has a long way to go toward fully recognizing this, I was glad to see that a recent casebook by Professors Lynn LoPucki and Andrew Verstein also emphasizes the strong congruity between these entity forms. *See* LYNN M. LOPUCKI & ANDREW VERSTEIN, BUSINESS ASSOCIATIONS: A SYSTEMS APPROACH (2020).

the corporation is a person, and thus subject to the full plethora of laws that bind people in society (both private and public law, from contract, through tort and environmental, to criminal law).[50] Decades of shareholderist writing on the corporation as a "nexus of contracts," or otherwise minimizing its entity status, may have caused some confusion (and contributed to stakeholderists' counter-response) in this regard.

Second, *within corporate law itself*, we find a set of mechanisms designed to ensure the corporation's legal compliance. Some duties are imposed on the corporate entity; others, on its fiduciaries. These devices begin with the foundational statement that a corporation may only engage in "lawful" acts or activities.[51] They continue with at least five different doctrines, all tied to the principle I identify here—and some currently undergoing a revival, in both practice and scholarship. These include the fact that a fiduciary's duty of loyalty contains a duty of good faith,[52] which in turn requires that the fiduciary not act "with the intent to violate applicable positive law";[53] the *Caremark* doctrine;[54] the change in corporate purpose, from entrepreneurial to custodial, when a corporation nears insolvency;[55] the rules conditioning the permissibility of

[50] For example, in the multidistrict civil litigation arising from the opioid epidemic, the vast majority of defendants are corporate entities. *See, e.g.*, County of Summit v. Purdue Pharma L.P. (*In re* Nat'l Prescription Opiate Litig.), No. 1:17-md-2804, 2018 U.S. Dist. LEXIS 213657, at *1-55 (N.D. Ohio Dec. 19, 2018). Moreover, "the plaintiffs seek remedies arising in such [non-corporate law] areas as tort law and unjust enrichment." Raz, *supra* note 3, at 554. On the corporation as subject to criminal law, see, for example, Mihailis Diamantis, *Clockwork Corporations: A Character Theory of Corporate Punishment*, 103 IOWA L. REV. 507 (2018).

[51] *E.g.* DEL. CODE ANN. tit. 8, § 102(a) (2020). Case law has also emphasized this point. *See, e.g.*, *In re* Massey Energy Co. Derivative & Class Action Litig., No. 5430-VCS, 2011 Del. Ch. LEXIS 83, at *73 (Del. Ch. May 31, 2011) ("Delaware law allows corporations to pursue diverse means to make a profit, subject to a critical statutory floor, which is the requirement that Delaware corporations only pursue 'lawful business' by 'lawful acts.'").

[52] *See* Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006).

[53] *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005).

[54] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996). For detailed discussion of *Caremark*'s recent reinvigoration, see Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013 (2019); Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3732838 [https://perma.cc/RW2M-MPUL].

[55] *See, e.g.*, Amir N. Licht, *My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency*, 99 WASH. U. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3680768 [https://perma.cc/Z9NP-4PK5].

dividends and buybacks on the corporation's continued solvency;[56] and the seniority of preferred shareholders, to the extent they have a non-residual (namely, contractual) claim toward the corporation.[57]

Clearly, the corporation's duty of legal obedience is deeply rooted. Corporate law is not, and never has been, about "shareholder primacy": more accurately, it is characterized by a norm of *legal primacy*. Until recently, commentators have paid much more attention to only one half of the corporation's purpose—the "pursuit of profit," rather than the equally important "lawful" part. Fortunately, this is starting to change, with the flux of scholarship on corporate obedience and compliance, which can be made even more robust by tying together the various aspects I discuss above.

Yet, just as shareholderists have been misguided in focusing on the "profit" part and minimizing the corporation's entity status, stakeholderists should re-examine the concept of "corporate social responsibility," and consider placing greater weight on a more fundamental idea: positive law. Telling corporate entities what their obligations are, and imposing sanction when those are violated, is far preferable to relying on a low-information normative framework, operationalized through the subjective determinations of changing fiduciaries in each corporation. This route is fairer and more efficient toward stakeholders, as well as toward corporations, who—like other people in society—are entitled to know what their legal duties are, and to be able to fulfill them.

Moreover, in terms of shaping corporate behavior (just like human behavior), law is not the only tool. The markets for products and services; the capital markets;[58] and reputational practices all influence what corporations do, and their effect on others' lives. It might be that a fiduciary who causes the corporation to operate lawfully, but in a manner that generates a consumer boycott, acts in an uninformed or careless way, and should therefore be penalized under corporate law. This question mainly resides in the domain of the business judgment rule. In any event, it requires the initial act on the part of consumers, which is not a matter of *law*. If, however, the corporation's behavior was unlawful, this stage of the inquiry ends there: legal sanction is

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[56] *See, e.g.*, tit. 8, §§ 160(a), 170-174.

[57] *See, e.g.*, LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del. Ch. 2010) ("[I]t is the duty of directors to pursue the best interests of the corporation and its common stockholders, *if that can be done faithfully with the contractual promises* owed to the preferred . . . ." (emphasis added)); Strine, *supra* note 14, at 2040.

[58] *See, e.g.*, Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020).

possible.[59] As I note in my second article, "[l]aw is imperfect, but it can be reformed—which requires going through the democratic, judicial, or regulatory process."[60] It is precisely such reform that would most decisively accomplish stakeholderists' necessary, and often urgent, end goals. Corporate law, for its part, has ample tools in place to maximize the likelihood that the law, once enacted, is obeyed.

For that to happen, however, corporate law itself must remain vital and enforceable. As my third article would show, even that cannot be taken for granted—and requires, once more, delving into the generations-old debate among internal and external perspectives on the law.

C. *Taking Corporate Law Seriously*

In a 2005 article, Professors Avi Bell and Gideon Parchomovsky write that, while the field of property law "seems to be in insoluble theoretic disarray, with scholars scrambling to assemble a giant puzzle of ill-fitting pieces,"[61] in fact, "[p]roperty . . . is center stage; it is a distinct and vital legal institution of its own merits with rules specifically designed to serve its purposes."[62] As I gradually came to realize, corporate law has the same problem—and should receive the same treatment. In other words, not only is there a habit of blanket pulling with regard to the internal structure of corporate law,[63] but corporate law *itself*—as a distinct legal institution—suffers from a "low-visibility problem,"[64] where members of the legal community often ignore the boundary separating it from other legal frameworks. We need to clarify what makes corporate law what it is—and, more pointedly, why it ought to be preserved going forward.

It turns out that the latter question is now standing for a real-life test. As I describe in my third article,[65] the federal courts—in at least one pending

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[59] *See, e.g.*, Pollman, *supra* note 54, at 2017 ("Delaware courts have prioritized giving directors broad latitude to take business risk by drawing a line at legal risk . . . .").

[60] Raz, *supra* note 3, at 550.

[61] Abraham Bell & Gideon Parchomovsky, *A Theory of Property*, 90 CORNELL L. REV. 531, 533-34 (2005).

[62] *Id.* at 615.

[63] *See supra* Section B.

[64] Raz, *supra* note 4, at 7, 60.

[65] *Id.*

case—are being asked to decide whether to introduce the practice of mandatory arbitration, as governed by the Federal Arbitration Act (FAA) and the U.S. Supreme Court's expansive precedents, into the corporate law realm.[66] If that happens, it would have highly detrimental, if not existential, effects for corporate law and governance: because managers and controlling shareholders will be able to unilaterally impose arbitration on their corporations; and because federal arbitration law is structured to suppress almost any possibility of intervention into unfair or inefficient practices (for example, class action waivers)[67]—it is clear that corporate law, which relies on litigation even more heavily than other areas, is in danger of becoming unenforceable. Meritorious cases could no longer be adjudicated, and those who choose to violate the equitable and fiduciary norms of corporate law would repeatedly get "free lunch," at the expense of corporate entities, shareholders, and sometimes stakeholders.[68]

There is a way out of this scenario, and—consistent with the broad theme of my dissertation—it requires us to take a look at what corporate law says and does, *as law*. Specifically, it demands that we examine corporate law's boundary question: where does corporate law start and other legal categories end? This inquiry is critical in the mandatory arbitration context, because, in order for the FAA to apply in a given situation, there must be a "contract" that contains the arbitration clause, as opposed to an instrument arising under some other category of law.[69] As I argue in the article, corporate law is, indeed, such a different category.

At present, corporate and contract law are often conflated, particularly by scholars.[70] Here we see a clear contrast between internal and external perspectives on the law: to an economist, "contract" might denote every situation in which *some* level of volition is involved. Legally speaking, however, contract requires more, including offer, acceptance, and most importantly, ex ante consent to known subject matter.[71]

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[66] *See id.* at 19-29.

[67] *See id.* at 12-16.

[68] *See id.* at 29-41.

[69] *See id.* at 6 n.21.

[70] *See, e.g.*, *id.* at 3 n.3, 43.

[71] *See, e.g.*, James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 279 n.91 (2015) ("[T]he requirement of definiteness is not a matter that the parties can waive if they are to have a contract. Indeed, it is tautological to

When we look into corporate law, an entirely different structure appears. In the article, I argue that corporate law (just like property,[72] and many other areas[73]) has a *unifying principle*, which I call the "open-endedness principle." The building blocks I have identified in my previous article (purpose, personhood, obedience, equity, and fiduciary duty) operate together to create a unique situation, where corporate entities can pursue open-ended adventures, without making any actual promise, ex ante, as to what they will achieve, if at all.[74] Instead, corporate law relies on ex post supervision, by courts of equity (the most well-known being those in Delaware), to both remedy and deter wrongdoing by corporations and their fiduciaries.[75]

The external perspective is not abandoned, however. As I explain, "[c]orporate entities both change the world, and adapt to it, in numerous, entirely unforeseeable ways. Through this, corporate law encourages innovation and entrepreneurship, in a manner that is impossible to attain by any other legal device."[76] My article thus aims to show that the legal, unwaivable structure of corporate law also generates an array of real-world benefits, extending well beyond the law itself.

Only if we take corporate law for what it is—"a distinct and vital legal institution of its own merits with rules specifically designed to serve its purposes"[77]—can we avoid both the specter of mandatory arbitration, and many other forms of injustice or inefficiency. This is a message that runs through all three articles in my dissertation. I believe the scholarly community is now in the process of rediscovering law, moving toward a more nuanced understanding that combines the insights of non-legal disciplines with the law's distinctive vantage point. Law can make the world a better place; in this regard, corporate law may be leading the charge—even if it still has substantial distance to cover.

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argue that the parties can agree to an indefinite level of performance, since there cannot be an agreement if parties do not know to what they have agreed.").

[72] *See* Bell & Parchomovsky, *supra* note 61, at 615 (stating the unifying principle that "property is best understood as a legal institution designed to create and protect the value inherent in stable ownership of assets").

[73] *See* Raz, *supra* note 4, at 44-46.

[74] *See id.* at 49-52.

[75] *See id.* at 52-55, 56-59.

[76] *Id.* at 52.

[77] Bell & Parchomovsky, *supra* note 61, at 615.

D. *Final Remarks*

My time at the University of Pennsylvania has been the most enriching, productive, and satisfying period of my life. Coming here in the summer of 2017, I could not yet imagine the sheer scope of this adventure. Both in and outside of legal academia, I tend to be a "long-distance runner," looking at the big picture of human affairs. This perspective has traditionally been somewhat muted in the field of corporate law, but based on what I have seen during my doctoral journey, that is changing for the better. I hope my dissertation has made a meaningful contribution in this regard.

In an august paper, written thirty-two years ago—and cited less often by present-day corporate law scholars than ought be—British philosopher Roger Scruton gets at the heart of corporate law's signature achievement. I close this Introduction with his words:

> [In a world without corporations,] [t]he primary thing that is missing, I believe, is the *long-term view*. No obligation endures there—not even the obligations of love and friendship—beyond the lifetime of the individuals who undertake them; nor does any obligation exist towards those who are not present to reciprocate it. The unborn and the dead are not only disenfranchised: they have lost all claim on the living. Their claims can be acknowledged only if there are persons who endure long enough to enter into personal relation, both with us, the living, and with them. The true public spirit—the spirit from which civil society and all its benefits derives—requires just such a projection of our duties beyond the grave. The care for future generations must be *entrusted* to persons who will exist when they exist: and if there are no such persons surrounding me, how can I have that care, except as a helpless anxiety? I can enter into no personal obligation that will bind me to past and future souls, nor can you. Only a corporate person can enter such an obligation, and only through corporate persons, therefore, can the relation to the unborn and the dead be made articulate and binding. . . .
>
> That this relation to the unborn and the dead is necessary for the fulfilment of the rational agent is something that we should not doubt. For it forms the premise of self-justification. The individual is justified by the knowledge that he did right by those who survive him, whom he never knew, and who promised him nothing; and equally by those who preceded him and bequeathed to him unknowingly their store of trust. In the broadest sense, then, the corporate person is

> necessary to the *ecology* of rational agency, and without it our aims will be as truncated as our lives.[78]

[78] Roger Scruton, *Corporate Persons*, 63 PROC. ARISTOTELIAN SOC'Y, SUPP. VOL. 239, 266 (1989) (quoted text reproduced with minor changes in ROGER SCRUTON, *Gierke and the Corporate Person*, *in* THE PHILOSOPHER ON DOVER BEACH 56, 72-73 (1990)).

SHARE LAW: TOWARD A NEW UNDERSTANDING OF CORPORATE LAW

ASAF RAZ*

ABSTRACT

Shares are an instrumental phenomenon in law, finance and modern life. Much of corporate law revolves around shares and shareholders, but our current understanding of shares is in a troubling posture: it resorts to various frameworks—contract, property, trust, and fiduciary law—neither of which can correctly accommodate the concept of shares. Contrary to prevailing notions, in both Delaware and other jurisdictions around the world, this Article proves that shareholders are not directly owed fiduciary duties; nor can they be simply described as contractual parties, due to the unique properties of shares as residual claims. Where do shares derive their value from? What rules and principles govern shares? The answer is that shares inhabit their own legal space. Weaving together corporate theory, doctrine, and real-life cases, this Article proposes the concept of share law, a new field of classification within corporate law. Share law, which is grounded in equity, provides the normative structure for conceptualizing, analyzing, and resolving share-related issues—including some very high-profile topics, such as dividends and buybacks, aspects of mergers and acquisitions, appraisal rights, multiple-class equity, sharehold-

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er voting and activism, and shareholder litigation. This Article presents a nuanced account, strongly supported both positively and normatively, of shares and their proper treatment within corporate and general law. In the process, it sheds new light on other areas in high currency, including corporate fiduciary law, corporate personhood, and the law of corporate purpose.

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1. INTRODUCTION

Shares are fascinating. This type of security, issued by corporations,[1] ignites the imagination for the perceived unlimited upside it offers to the lucky investor who picks the "right" share. On a more concrete level, shares form the spinal column of modern economy. The total value of shares publicly traded on the world's exchanges, in 2017, was more than US$77 trillion.[2] Peoples' life savings lean on shares, or share-related instruments and schemes.[3] Share offerings finance the global expansion of human activity through corporations. In addition, shareholders—not other creditors—have a substantial degree of control over the governance mechanisms of corporations, through voting and other means, including access to certain types of legal actions. Since corporations are immensely important actors in today's world, shareholders occupy a unique position indeed.

Against this backdrop, it is troubling to realize how little we know about shares. Other types of corporate obligations, such as bonds, emanate from detailed contracts, defining the parties' rights and duties. Even where the contract itself is lacking, contract *law* provides ample solutions. When we turn to the "share contract"—the corporation's constitutional documents[4]—we quickly discover

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1 In this Article, "corporation" alternates between two meanings. Mostly, it refers to several different types of artificial persons, which include the company, the cooperative, the partnership and others, as far as the range of corporate laws in a given jurisdiction allows. They include both for-profit and other-purpose corporations. Related phrases, such as "corporate law," should be accordingly construed. More narrowly, a "corporation" is how Delaware and similar U.S. law describes the type of entity which other jurisdictions, including Israel and the U.K., call a "company." *See* Delaware General Corporation Law, DEL. CODE ANN. tit. 8, ch. 1 (2018) [hereinafter: DGCL]. This duality is not problematic, since every Delaware corporation is also a corporation in the broader sense. Where relevant in this Article, it is clear that the reference is to Delaware corporations, rather than corporations in the more general sense.

2 *See Stocks traded, total value (current US$)*, THE WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.TRAD.CD [https://perma.cc/622W-XFFC] (last visited Oct. 26, 2018). The numbers stated in that source should be considered in addition to the value of shares issued by private, or non-publicly-traded, corporations.

3 *See generally* MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY (2016) (discussing many types of investment schemes and institutions, such as pension funds, securities firms, mutual funds, private equity funds and derivatives, having shares as part of their asset portfolio or as their underlying asset).

4 In corporate law, constitutional documents are certain documents required

that it is a patently *undetailed* agreement,[5] augmented only to a limited extent by statutory provisions.[6] Furthermore, the very nature of the obligation toward shareholders is "residual," meaning that it derives from the constantly fluctuating difference between the corporation's assets and liabilities. Due to these factors, shareholders' legal position *cannot ever* be well-defined in advance. Based on what concepts, doctrines and principles should we examine share-related issues? As this Article reveals, not only contract law is unsuited to explain shares; so are the fields of property, trust and fi-

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in order to create a corporation. Usually, they govern some fundamental aspects of the corporation's identity and affairs. They are also a normative source (mostly, a contract) binding the corporation and its residual claimants, the first of whom are also its founders. *See, e.g.*, DGCL § 101(a) (stating that every corporation shall have a certificate of incorporation); STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del. 1991) ("[A] corporate charter is . . . a contract between . . . the corporation and its shareholders. . . . The charter is also a contract among the shareholders themselves."); Companies Act, 5759-1999, §§ 15, 17(a), SH No. 1711 p. 189 (Isr.) [hereinafter: Israel Companies Act] ("Every company shall have an article of incorporation . . . ."; "The article of incorporation is legally a contract between the company and its shareholders and between [the shareholders] themselves."). Constitutional documents are sometimes called "organizational documents," *see, e.g.*, Sylvia Ann Mayer & Manesh Jiten Shah, *I Wish I May, I Wish I Might... File Chapter 11 Tonight: Authorization and D&O Considerations When Filing Chapter 11*, WEIL BANKRUPTCY BLOG 2 (Nov. 2010), http://business-finance-restructuring.weil.com/wp-content/uploads/2011/04/Mayer_BK10_Paper.pdf [https://perma.cc/Q5SZ-Y5KD] ("[T]he organizational documents (such as the charter, articles of incorporation, bylaws, limited liability company ("LLC") agreement, or partnership agreement) . . . ." (emphasis omitted)).

5 In Delaware, the list of mandatory clauses for a certificate of incorporation is very short: the corporation's name, address, goals ("The nature of the business or purposes to be conducted or promoted."), authorized share capital and the names and addresses of the corporation's founders. *See* DGCL § 102. In Israel, only four clauses are mandatory in every article of incorporation (the sole constitutional document required under the Israel Companies Act): the company's name, goals, authorized share capital and type of liability limitation (if any). Additionally, the article of incorporation has to be signed by the company's founders (its first shareholders). *See* Israel Companies Act §§ 18, 23.

6 Several sections of the Delaware corporate statute deal with shares, *see* DGCL §§ 102, 109, 151–174, 201–205, 211–233, 241–245, in addition to other sections where share law issues are intermittently mixed in with others, such as the merger and dissolution provisions in DGCL §§ 251–267, 271–285. For statutory share law in Israel, *see* Israel Companies Act §§ 1, 15–24, 33–35, 57–91, 127–139, 176–193, 285–313. Importantly, most of these sections contain fairly broad statements and do not attempt to provide rules of conduct or decision even for known types of share-related disputes, such as share dilution, withholding of dividends, or unfair prejudice. Similarly, none of them explain how the rights attached to shares are different from those attached to any other security or corporate obligation; none of these provisions address the unique nature of residual claims and the problems they give rise to. The same is true of constitutional documents, even when they are more detailed than the minimum statutory requirements.

duciary law. Presumably, the share is a legal mystery. We are seemingly unable to answer even a simple question: "why do shares have value?" Yet, around US$80 trillion hinges on our answer.[7]

One reason for this gap is habit and routine. Dividends and merger proceeds get paid, or not; shareholder voting effects change, or not. It often feels as if corporations' successes and failures translate directly enough into shareholders' pockets. The most familiar perception of shares comes from the *secondary* market: the trading of shares in a stock exchange, with their prices going up and down. Not enough attention is paid to the underlying nature of shares, and the rules and principles governing them—in short, to *share law*.

However, such attention is highly necessary. It is required in order to grapple with very salient questions, such as shareholders' power compared to that of directors, or the position of non-shareholder constituencies. Additionally, things *do* go wrong within the relationships that shareholders are parties to: for many reasons, the corporation's fortunes might *not* translate into those of its shareholders, or part of them. That happens constantly, and in surprising ways. Due to their unusual characteristics, shares give rise to a very wide range of possible situations. To realize how broad that range is, it might be beneficial to take a look around the globe.

In September 2017, the Supreme Court of Israel issued its decision in *General Guardian v. Co-Op Blue Square Services Cooperative Ltd. (In Liquidation)*.[8] In that judgment, the Court held that the economic rights of shareholders cannot be taken away from them solely because they cannot be located. The Court ordered that, instead, those rights (here, a liquidating dividend in cash, totaling approximately US$15 million) will be held in trust, for the benefit of the unknown shareholders, for an unlimited period of time, to be claimed by the unknown shareholders when they do appear.

The *Co-Op* decision sheds profound light on the fundamental concepts relating to shares, not only in Israel, but under perceptions that evolved globally, since the birth of modern corporations. The decision is illuminating precisely because the Court struggled

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7 *See supra* note 2.

8 CA 238/16 Gen. Guardian v. Co-Op Blue Square Servs. Coop. Ltd. (In Liquidation) (Sept. 10, 2017) (Isr.) [hereinafter: *Co-Op*], http://elyon1.court.gov.il/files/16/380/002/N21/16002380.N21.pdf [https://perma.cc/G5VJ-7K6Y].

to reach this outcome. Israel has a developed economy, with a common law system[9] featuring highly sophisticated bodies of corporate and other private law.[10] Yet, the Court could find no statutory, case law or contractual provisions clearly establishing that shareholders are entitled to the economic rights arising from their shares, and that this entitlement is unlimited in time. The opinion of the Court, by Judge David Mintz, relied on an amalgamation of written law provisions to reach the result.[11] In a concurrence,[12] Judge Daphne Barak-Erez attempted to formulate a broader principle: share rights are "property" rights, so that, like other types of property, they enjoy strong, constitutional protections and cannot be simply taken away from their owners.

In fact, the *Co-Op* Court operated as a court of equity, treating shareholders' claims as equitable rights, with the attendant results. Mainly, in this case, shareholder rights were regarded as quasi-property rights,[13] similar to (albeit different than) a trust beneficiary's rights. Like other equitable rights, those rights are both obligatory, toward the corporation; and quasi-proprietary, toward

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9 *See, e.g.*, AMIR N. LICHT, DINEI EMUNA'UT: HOVAT HA'EMUN BA'TA'AGID U'BA'DIN HA'KLALI [FIDUCIARY LAW: THE DUTY OF LOYALTY IN THE CORPORATION AND IN THE GENERAL LAW] 23–24 (2013) ("[T]he question of Israeli law's classification into a legal family, if it was ever controversial, is no longer in dispute. The answer is clear: Israeli law is common law . . . .").

10 *See generally* INTRODUCTION TO THE LAW OF ISRAEL (Amos Shapira & Keren C. DeWitt-Arar eds., 1995); ALON KAPLAN, ISRAELI BUSINESS LAW (1999); Itai Fiegenbaum & Amir N. Licht, *Corporate Law of Israel* (Eur. Corp. Governance Inst., Working Paper No. 372, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3050329 [https://perma.cc/LK8K-8CT7].

11 *But see infra* pp. 306–07 (describing how the equity approach, which the Court perceives as obvious, "operates behind the scenes" of the decision and motivates the outcome).

12 *See Co-Op* at 28.

13 The concurrence, *id.*, uses the term "property rights", but that wording (which does not appear in the opinion of the Court) is inaccurate. *See infra* Part 5.2 (explaining that shareholder rights toward the corporation's net worth are not property rights under property law). Alternatively, the concurrence might have referred not to the rights contained *in* the share, but to shareholders' rights *toward the share*. The latter are, indeed, property rights. *See infra* pp. 275–76. Of course, this does not resolve the legal content of the share itself. In *Co-Op*, shareholders' property rights toward their shares were undisputed; the issue was their right to receive a portion of the corporation's assets, which is one of the rights embedded in the share, and is governed by equity-based share law. Finally, the concurrence might have referred to "property rights" in a constitutional law sense, which is not congruent with private law classifications, and might include all manner of economic rights, whether proprietary, equitable, or obligatory. In constitutional and human rights law, such an approach is generally warranted.

the shareholder's respective portion of the corporation's net worth. Indeed, net worth is also known as "shareholders' equity." That is one verification of the link between shares and equity; this Article details many others. Current approaches to shares rely on various legal disciplines, but none of these correctly and fully explain the share phenomenon. Equity is the basis of share law, both in positive law (people act according to this approach since the birth of modern corporations[14]) and normatively. The rights, and even the *existence*, of shares and shareholders cannot be adequately explained any other way. Especially when dealing with such extent of capital and such a scope of human interests, it is crucial to understand where shares come from, which actions pertaining to them are permissible, and what the parties to share-borne relationships may expect.

This Article weaves together theoretical, doctrinal and comparative approaches, producing a consistent model of corporate law and its subdivisions. To that end, this Article mainly surveys two jurisdictions: the United States, the prominent arena of business and legal activity in the world, and within it, as pertains to corporate law, mainly Delaware; and Israel, a country with a well-developed commercial sphere, legal system and common law jurisprudence, where the *Co-Op* case took place. Occasionally, this Article turns to other jurisdictions, such as the United Kingdom, which is historically the source of both American and Israeli law. Many of the core concepts of corporate and other private law are very similar among these jurisdictions—which makes any differences all the more telling.

The issues that comprise share law have been with us since the dawn of corporations. This Article, for the first time, introduces the concept of share law as a separate classification. It explores both the theoretical foundations of share law, and many of the practical topics it encompasses. This Article aims to assist future inquiries by businesspeople, investors, lawyers, judges and scholars, as it presents a unified framework for resolving the many questions that emerge from the share phenomenon. While doing so, this Article also provides a more nuanced understanding of such areas as corporate personhood and corporate purpose—other paradigms that give rise to some of the most pressing issues facing today's corporate jurisprudence.

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14 *See infra* Part 6.3.

2. THE *CO-OP* CASE: FACTS, LAW AND JUDGMENT

Before the establishment of the State of Israel in 1948, the land was under British mandate rule. British law in force, which was later absorbed into the law of Israel,[15] enabled people to start a regular business company; that was, as it still is in Israel, the most common type of corporation. The law also afforded promoters the option of establishing another, more unique type of corporation: a cooperative. This type of entity, having strong roots in the U.K. itself,[16] is a for-profit,[17] separate legal person,[18] with optional limited liability for shareholders.[19] These characteristics make a cooperative similar to other for-profit corporations. However, a cooperative also has several unique traits, intended, as its name implies, to foster social cooperation among its shareholders or "members." These include, among other things, restrictions on the maximum stake of the cooperative's outstanding shares any single shareholder can own (set at 20%);[20] a mandatory "one shareholder, one vote" rule;[21] and a rule excluding cooperative shares from being subject to a lien,[22] apparently intended to restrict their transferability to outsiders not as committed to the cooperative's goals as voluntary members are.

One of those corporations, established in 1942 and continuing to exist in Israel,[23] is Co-Op Blue Square Services Cooperative Ltd.

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15 *See* Law and Administration Ordinance, 5708-1948, § 11, O.B. (Official Bulletin) No. 2 p. 1 (Isr.) (the first legislative act enacted in the State of Israel; this section declaring that the existing law of the land continues to be valid, as part of the law of Israel).

16 *See generally* JOHN F. WILSON ET AL., BUILDING CO-OPERATION: A BUSINESS HISTORY OF THE CO-OPERATIVE GROUP, 1863-2013 (2013).

17 *See* Cooperatives Ordinance, §§ 39, 40, HEI (Laws of the Land of Israel) Vol. 1 p. 336 (1933) (Isr.) [hereinafter: Israel Cooperatives Ordinance] (providing rules in regard to the cooperative's profits and the permissibility of various actions pertaining to them). Alternatively, a cooperative may be described as a "mixed-purpose" corporation; one purpose within the mix is the pursuit of profit.

18 *See id.* at § 21.

19 *See id.* at § 4.

20 *See id.* at § 5(1).

21 *See id.* at § 16.

22 *See id.* at § 25.

23 *See* *Cooperative Search*, MINISTRY OF ECONOMY, https://apps.moital.gov.il/CooperativeSocieties [https://perma.cc/8E32-6EFH] (last visited Oct. 26, 2018) (search for cooperative number 570004465; indicating that the cooperative was founded on Mar. 4, 1942 and is in liquidation proceedings).

(Co-Op). This entity was in the business of food retail and distribution of produce; before its liquidation, it mainly operated through subsidiaries, many of them regular commercial companies.[24] As the years passed, Co-Op amassed substantial earnings: during its liquidation proceedings, its assets were sold for over 1.3 billion NIS (New Israeli Shekels),[25] equivalent in 2017 rates to about US$370 million.[26]

In 2002, Co-Op entered into court-ordered liquidation. The reasons for that decision are not pertinent for current purposes, but importantly, it is a non-bankruptcy liquidation: the corporation maintained a positive net worth (shareholders' equity), on the order of the sum of its assets. A cooperative is a for-profit, or at least mixed-purpose corporation; incidental to that, the persons entitled to receive its net worth, when it is distributed, are its shareholders.[27] Accordingly, the liquidator, appointed by the District Court of Tel Aviv, set out to distribute among shareholders the cash proceeds, gained from the sale of the corporation's assets. Most shareholders were indeed located and received their due fraction of the corporation's net worth. As a matter of course, that fraction derives from the relation between the number of shares owned by the shareholder and the number of outstanding shares.

There was a problem, however, which ended up at the heart of the case. Due to the age of the corporation and the time passed since the allocation of most of its shares—which were not publicly traded—it turned out to be impossible to contact the owners of about 10% of the outstanding shares. Many simply changed their addresses. It is naturally apparent that many shareholders passed away; this does not materially change the legal analysis, since their

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24 *See infra* note 31, para. 3.

25 *See* Brief for Appellant, para. 6, CA 238/16 Gen. Guardian v. Co-Op Blue Square Servs. Coop. Ltd. (In Liquidation) (Isr.), http://www.justice.gov.il/Pubilcations/Articles/Documents/KO_OP_FINAL.pdf [https://perma.cc/8JWX-WUH5].

26 *See Exchange Rates*, BANK OF ISRAEL, http://www.boi.org.il/en/Markets/ExchangeRates/Pages/Default.aspx [https://perma.cc/P9XT-PKWL] (last visited Oct. 26, 2018) (search for the exchange rate on Sept. 10, 2017; indicating that on the day of the *Co-Op* decision, the exchange rate was 3.504 NIS for 1 U.S. dollar).

27 *See* Israel Cooperatives Ordinance §§ 39, 40; Companies Ordinance (New Form), 5743-1983, § 284, DMI (Laws of the State of Israel) No. 37 p. 761 (Isr.) [hereinafter: Israel Companies Ordinance] (providing rules in regard to the distribution of profits to shareholders, during the corporation's ongoing existence or during liquidation).

claims passed on to their heirs.[28] The liquidator did manage to locate some previously unknown shareholders, and at present they continue to show up, gradually.[29]

By 2015, the liquidation proceedings seemingly reached an impasse. All of the corporation's assets had been sold. The liquidating dividend was fully distributed to the known shareholders. It was perceived by many, including the liquidator and representatives of the known shareholders, that the chances of locating more unknown shareholders were becoming slimmer as time passed—although previously unknown shareholders *did* continue to show up, at however seemingly slow rate.[30] In 2015, the liquidator filed a motion with the lower court, the District Court of Tel Aviv, asking to end the liquidation proceedings, wind up the corporation and, most importantly, order the distribution of all remaining funds between the *known* shareholders, irrevocably nullifying the claims of currently unknown shareholders, even if they show up in the future. The known shareholders—the only ones appearing before the court—agreed to this, unsurprisingly. The lower court granted the motion.[31] Its decision did not include substantive discussion on the merits of the unknown shareholders' legal or equitable rights; rather, it was based on practical considerations, primarily the seeming inability to locate any more unknown shareholders expeditiously enough, in light of the liquidation stretching out for many years.[32] The lower court's decision also took somewhat for granted the link between winding up the corporation and distributing the remaining funds to the known shareholders. It did not expound on another possibility: depositing the remaining funds in trust, for the benefit of the unknown shareholders—although the appellant did raise this option before the lower court.[33]

The General Guardian, an agency of the Israel Ministry of Jus-

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[28] *See* Inheritance Act, 5725-1965, § 1, SH No. 446 p. 663 (Isr.) ("Upon a person's death his estate passes to his heirs.").

[29] *See Co-Op*, para. 5.

[30] *See id.*

[31] *See* LC (Liquidation Case) (TA) 1153/02 Co-Op Blue Square Servs. Coop. Ltd. v. Levitt (Nov. 26, 2015) (Isr.), https://www.nevo.co.il/psika_html/mechozi/ME-02-1153-521.htm [https://perma.cc/L7JD-JM44].

[32] *See id.*, para. 10.

[33] *See id.*, para. 9.

tice entrusted by statute[34] with representing the interests of property owners who are unidentified or unable to appear in court, timely appealed to the Supreme Court. The appellant also moved to stay the distribution to the known shareholders, until the appeal is decided. The Court granted this stay, soon after the appeal was filed.[35] The amount corresponding to the unknown shareholders' claims totaled 53 million NIS[36] (approximately US$15 million in 2017 rates[37]). At this stage, the unknown shareholders numbered 2,600,[38] giving each a claim of about US$5,700. If the lower court's judgment was to stand, they faced an irreversible loss of this amount.[39]

In September 2017, the Supreme Court issued its judgment in the case.[40] The opinion of the Court was written by Judge David Mintz, a 2017 appointee to the Court, who previously served on the District Court of Jerusalem and is renowned for his expertise in bankruptcy law.[41] Judge Yoram Danziger, the most senior member of the three-judge panel, joined in Mintz's opinion.[42]

The Court's analysis begins with a survey of the law of cooperatives, noting, as mentioned above, the dual nature of this type of corporation, which harbors both social and economic purposes.[43] Importantly, the Court then mentions that a cooperative's existence, like that of other corporations, is based on a constitutional

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[34] *See* General Guardian Act, 5738-1978, SH No. 883 p. 61 (Isr.).

[35] *See* CA 238/16 Gen. Guardian v. Co-Op Blue Square Servs. Coop. Ltd. (In Liquidation) (Feb. 2, 2016) (Isr.), http://elyon1.court.gov.il/files/16/380/002/O05/16002380.O05.pdf [https://perma.cc/MY5P-WCU3].

[36] *See supra* note 31, para. 9.

[37] *See supra* note 26.

[38] *See Co-Op*, para. 5.

[39] If the funds had been distributed among the known shareholders, then even if the lower court decision would have been later found to be in error, there is absolutely no procedural mechanism, either in Israel or in other countries, including the U.S. and U.K., that enables one (such as a previously unknown shareholder) to pursue an action seeking remuneration from a very large number of dispersed people (such as the tens of thousands known shareholders). A class action only works the other way around.

[40] *Co-Op*, *supra* note 8.

[41] *See Justices and Registrars of the Supreme Court*, SUPREME COURT OF ISRAEL, https://supreme.court.gov.il/sites/en/Pages/Justices.aspx [https://perma.cc/X2ZN-ZTBS] (last visited Oct. 26, 2018).

[42] *See Co-Op* at 27–28.

[43] *See id.*, para. 19.

document—the article of incorporation.[44] This relates to the contractual approach to shares, discussed below.[45] The Court goes on to mention the strong link between company law and cooperative law, stating that doctrines from other areas of corporate law may be "imported" into cooperative law.[46] This is consistent with the methodology employed in this Article, viewing corporate law as a general field, with different types of corporations, having similar traits, entitled to similar treatment. In other words, although *Co-Op* involves a unique type of corporation, its lessons are fully applicable to "regular" companies and other corporations.

The Court then delves into a prolonged analysis of various provisions, gathered from cooperative law, bankruptcy law (occupying a large part of the opinion, even though the Court acknowledges the large positive net worth of the corporation, and that shareholders are its intended recipients;[47] this analysis might be expected, considering that most liquidation activity arises in bankruptcy), comparative law from the U.K. and U.S., Hebrew law, and even administrative law, but importantly, by the end of that part of the opinion,[48] the outcome remains to be clarified. Unsurprisingly, neither of these sources provide clear rules as to the unique situation involving unlocated shareholders in a liquidating corporation, entitled to large sums of money and facing (unbeknownst to any of them) a motion to distribute those funds among other, known shareholders.

Two statutory provisions mentioned by the Court come close to providing a decisive rule in the case. The first, Section 372 of the Israel Companies Ordinance, states that if some of the liquidating company's funds, held by the liquidator, are not duly claimed by anyone within six months, they shall be deposited in a bank account; if the claimant later appears, the funds shall then be paid; that section places no time limit on making the claim.[49] However, the Court mentions that non-shareholder creditors' claims *are* time-limited, by other statutory provisions, which the Court declines to apply to shareholders.[50] Why are shareholders different? Also,

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44 *See id.*, para. 20.

45 *See infra* Part 5.1.

46 *See Co-Op*, para. 21.

47 *See id.*, para. 2.

48 *See id.*, paras. 25–64.

49 *See* Israel Companies Ordinance § 372.

50 The Court simply states that "a shareholder is not required to file a proof of claim, since he is not considered as a creditor of the company but a participant

what if Section 372 did not exist, or if it was less sufficiently worded (common predicaments of statutory law)? The second statutory provision, Section 248 of the Israel Companies Ordinance, deals with distributions to shareholders during the company's liquidation, ordering as follows: "A sum that a [shareholder] is entitled to due to being a [shareholder] . . . shall be taken into account in regard to adjusting the rights of all [shareholders] among themselves."[51] The Court invokes this provision to state that "there is no place to benefit one shareholder at the expense of another."[52] Again, besides merely quoting the statute, the Court does not explain how shareholders are different than other creditors.[53] Yet, this short provision does allude to an important principle of equity-based share law: the equality between identical shares (and hence, between equal shareholders).

The Court then announces the result: the lower court's decision is overturned. The monetary rights of the unknown shareholders shall be held in trust, by the appellant, for each shareholder to receive whenever in the future they may appear.[54]

In a short concurrence,[55] Judge Daphne Barak-Erez joins Judge Mintz's opinion. She also offers another explanation for the eternality of shareholders' rights: "The rights of the unknown shareholders are property rights for all intents and purposes. These are fundamental rights, which today even enjoy constitutional protection."[56] The concurrence also points out that "the known share-

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in it. Therefore, applying here the provisions relevant to a "creditor" would be problematic." *Co-Op*, para. 66. The term "participant" is synonymous with "shareholder," *see id.*, para. 67. The Court does not elaborate on what gives rise to this distinction between "creditor" and "shareholder."

51 Israel Companies Ordinance § 248.

52 *Co-Op*, para. 66.

53 Notably, the *pari passu* equality rule, which Israel Companies Ordinance § 248 secures to shareholders, also applies to creditors under general and bankruptcy law. At the bottom line, the Court's conclusion in paras. 65–67 of the opinion is simply that "creditors" must file a proof of claim in liquidation proceedings, and have a limited period of time to do so, while "shareholders" are different in both respects. This conclusion is not explained by the statutory language or the Court's discussion, *but see infra* pp. 306–07 (describing how the equity approach, which the Court perceives as obvious, "operates behind the scenes" of the decision and motivates the outcome).

54 *See Co-Op*, para. 70.

55 *See id.* at 28.

56 *Id.* Regarding the use of the term "property rights," *see supra* note 13. The constitutional protection referred to comes from Basic Law: Human Dignity and Liberty, § 3, SH No. 1391 p. 150 (Isr.) ("There shall be no violation of the property of a person.").

holders never had any legitimate expectation grounded in law to receive more than their respective fraction of the cooperative's assets. They are not the unknown shareholders' natural "heirs" or their partners."[57] This, again, is an allusion to principles of equity, such as the maxim "equity delights in equality."[58] In other words, there is no difference between a known and an unknown shareholder, at least none that justifies forfeiting the latter's rights and giving them to the former.

This is a remarkable decision, reached from a remarkable factual background. It warrants further discussion. What is the *fundamental* basis of *Co-Op*—and indeed, of shareholder rights and shares generally?

3. CLASSIFICATIONS IN CORPORATE LAW AND THE UNIQUENESS OF SHARES

The difficulty faced by the Court in *Co-Op* arises, to a large extent, from a gap in the way we currently classify the structure of corporate law. This Article explains how to close that gap. Its existence is somewhat perplexing, because lawyers must classify, and do so all the time. Peter Birks wrote that "taxonomy is the foundation of most of the science . . . . Without it there is only a chaos of unsorted information . . . . A sound taxonomy . . . is an essential precondition of rationality. . . . Abolition of categories would entail abolition of thought."[59] Pertinently, he warned that "[a]ll these are wanting in common law systems."[60] Corporate lawyers, in particular, classify a lot of things: is the claim derivative or direct? Is the transaction a merger or an acquisition? Was the breach of a duty of loyalty or care? Which statutory sections govern the current situation? Yet, the question is whether they are classifying *enough*.

Today, when we discuss corporate law, we often perceive one class of matters to "lie at its heart," or even amount to *all* of corporate law.[61] These matters can be termed *corporate fiduciary law*.[62] It

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57 *Co-Op* at 28.

58 MICHAEL LEVENSTEIN, MAXIMS OF EQUITY 103 (2014).

59 Peter Birks, *Equity in the Modern Law: An Exercise in Taxonomy*, 26 U. W. AUSTL. L. REV. 1, 3–7 (1996).

60 *Id.* at 4.

61 An example of this partial view is provided by Goshen and Hannes, who dramatically announce "the death of corporate law," while actually describing some changes in a specific area of corporate law—the balance of power between

is the law governing the relationships between a corporation and its fiduciaries, that is, the people who owe it fiduciary duties. These include directors, other officers (such as managers), controlling shareholders and others. Such well-discussed and litigated topics as self-interested transactions,[63] appropriation of corporate opportunities,[64] and executive compensation[65] are part of corporate fiduciary law. Also within this field are some structural issues, such as the prerequisites for a new director appointment, the operation of board committees, or the roles of independent directors.

Indeed, corporate fiduciary law is a necessary, defining component of corporate law, and there is a fundamental reason for that: *every* corporation *must* have at least one fiduciary at any given moment. A corporation is a person, but not a natural person. It does not have eyes and hands, or any other bodily and cognitive capacities, entirely of its own. Therefore, it always has to operate through someone else (the fiduciary), whom by design it entrusts with acting in its benefit. While part of corporate law, corporate fiduciary law is also part of the broader field of fiduciary law.[66] The norms governing trustees, lawyers and many others,[67] even in non-corporate contexts, are part of fiduciary law. The unique duty characterizing fiduciary law is the duty of loyalty. Its underlying theme is the fiduciary principle: a fiduciary must single-mindedly act to the advantage of the beneficiary, without being swayed by

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directors, activist shareholders and courts. *See* Zohar Goshen & Sharon Hannes, *The Death of Corporate Law* (Eur. Corp. Governance Inst., Working Paper No. 402, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3171023 [https://perma.cc/8EFR-CGMG]. That article treats a narrowing in the scope of corporate fiduciary law (at least as it is traditionally perceived) as a decline of all corporate law. In fact, shares and shareholders, with their voting and other rights, are also part of corporate law, which is alive and well.

62 *See, e.g.*, David Kershaw, *The Path of Corporate Fiduciary Law*, 8 N.Y.U. J. L. & BUS. 395 (2012); Lawrence A. Hamermesh & Leo E. Strine, Jr., *Fiduciary Principles and Delaware Corporation Law: Searching for the Optimal Balance by Understanding That the World is Not* (Univ. of Pa. Law Sch. Inst. for Law & Econ., Research Paper No. 40, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3044477 [https://perma.cc/ZBL3-UKS7] (using the term "corporate fiduciary law").

63 *See generally* WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 292 (5th ed., 2016).

64 *See generally id.* at 328.

65 *See generally id.* at 343.

66 Many volumes are devoted to general, rather than only corporate, fiduciary law. *See, e.g.*, TAMAR FRANKEL, FIDUCIARY LAW (2011); LICHT, *supra* note 9; LEONARD I. ROTMAN, FIDUCIARY LAW (2005).

67 For a partial list, *see* ROTMAN, *supra* note 66, at 15.

any other interest.[68] This is a much higher standard of behavior than that pertaining to regular, arm's length obligations, where each party is free to benefit itself. It arises when the fiduciary agrees to undertake this position, which involves the power to unilaterally affect the beneficiary's affairs and legal standing. The fiduciary also has absolute advantage in information over the beneficiary. Due to these power and information asymmetries, the regular law of obligations is insufficient, and a heightened type of duty is invoked to protect the beneficiary's interests, and more generally, justice and fairness. As a result, fiduciary law is known for its strictness toward fiduciaries.[69] Given this rigidity, corporate

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[68] *See, e.g.*, Birnbaum v. Birnbaum, 539 N.E.2d 574, 576 (N.Y. 1989) ("[I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect . . . . This is a sensitive and "inflexible" rule of fidelity, barring not only blatant self-dealing, but also requiring avoidance of situations in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty . . . . Included within this rule's broad scope is every situation in which a fiduciary, who is bound to single-mindedly pursue the interests of those to whom a duty of loyalty is owed, deals with a person "in such close relation [to the fiduciary] . . . that possible advantage to such other person might . . . consciously or unconsciously" influence the fiduciary's judgment . . . ." (third and fourth alterations in original) (second brackets in original) (citations omitted)); Bristol & W. Bldg. Soc'y v. Mothew [1996] EWCA (Civ) 533, [1998] Ch 1 at 18 (appeal taken from Eng.) (describing the conditions that give rise to a fiduciary relationship, stating that "[a] fiduciary is someone who has undertaken to act for or on behalf of another . . . in circumstances which give rise to a relationship of trust and confidence."; also describing the main obligations imposed on fiduciaries, including that "[t]he principal is entitled to the single-minded loyalty of his fiduciary."). This Article generally employs the American view of the scope of fiduciary duties, subsuming both loyalty and care. In other jurisdictions, fiduciary law might be understood to encompass only the duty of loyalty. *See, e.g.*, Christopher M. Bruner, *Is the Corporate Director's Duty of Care a "Fiduciary" Duty? Does It Matter?*, 48 WAKE FOREST L. REV. 1027, 1028 (2013) ("[U]nlike the United States, other common law jurisdictions including the United Kingdom, Australia, and Canada generally do not conceptualize the duty of care as "fiduciary" in nature.").

[69] *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . . The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation."); Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) ("Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has devel-

fiduciary law employs mechanisms, such as the business judgment rule, meant to apply when the duty of loyalty has *not* been breached, in order to promote the dynamics of corporate life and other policy considerations that arise in the corporate context.[70]

However, corporate fiduciary law is only one part of corporate law. The fiduciary-corporation relationship is one of the *two* main relationships that uniquely define corporate law. When classifying corporate law, we also encounter a set of issues that are non-fiduciary or only partly fiduciary in nature. We talk about these topics in law school classes, practice them as lawyers, adjudicate them and draft statutes that govern them. These issues are at the heart of corporate law just as much as corporate fiduciary law is. They deal with the second group of persons[71] that *must* exist in relation to *every* corporation. In the broadest terms, that group may be called "residual claimants." Every corporation, at any given moment, has at least one of those.[72]

The underlying reason for this is that a corporation's life can end, as it often does, whether through merger or liquidation.

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oped a tradition that is unbending and inveterate.").

70 *See, e.g.*, Hamermesh & Strine, *supra* note 62, at 11 ("One of the earliest refinements in Delaware corporate fiduciary law was the articulation of the business judgment rule."). The article also discusses the rule's application and some of its justifications.

71 In most corporations, the same person can be a member of both groups, that is, a fiduciary for the corporation and its residual claimant, at the same time.

72 The absolute necessity of both fiduciaries and residual claimants can also be stated as follows: unlike a natural person, who is under no inherent duty to enter into any contract, a corporation, by design, *must* be party to at least two contracts, at any moment of its existence: one with its fiduciary (or fiduciaries) and the other with its residual claimant(s). This stems from first principles, described in this Part of the Article (the corporation, not being a natural person, is only able to act through others; the need to determine who would be entitled to receive the corporation's net worth at the end of its life), and from written law. *See, e.g.*, DGCL §§ 101(a) (stating that every corporation shall have a certificate of incorporation), 151(b) (instructing that after share redemption, the corporation must have at least one outstanding share); STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del. 1991) ("[A] corporate charter is . . . a contract between . . . the corporation and its shareholders."); Israel Companies Act §§ 15, 17 (stating that every company shall have an article of incorporation, and that it is a contract between the company and its shareholders); DGCL § 141(b) (stating that every corporation's board must include at least one director); Israel Companies Act § 219(b) (stating that every company must have at least one director). Regarding the contractual aspect of the fiduciary-corporation relationship, *see, e.g.*, *Bristol v. Mothew*, [1998] Ch 1 at 18 (stating that the fiduciary position has to be "undertaken" by the fiduciary), meaning that the relationship is based on agreement—while also, by definition, absorbing the norms of fiduciary law. Some of the fiduciary's "employment contract" may also be, and often is, in writing.

When that happens, the corporation's interests (assets and non-economic interests alike) do not disappear. If the corporation has liabilities (including both economic and non-economic obligations), then according to general law,[73] its interests must first go toward satisfying those. Yet only rarely, if ever, do a corporation's interests precisely equal its liabilities. There must be *some* person entitled to receive the difference, or "residual."[74] That person is the residual claimant.

Crucially, a corporation has residual claimants throughout its life, not only at or near its end. To explain this, the analysis above needs to be expanded. The phenomenon can be first explained in contractual terms: when a corporation is formed, its founders also choose its first residual claimants (usually themselves); that choice is found in the constitutional documents.[75] Put another way, the persons entering into that particular contract accept, as part of their contractual bargain, the fact that they are the residual claimants. Conversely, parties to other relationships with the corporation accept the fact that they are *not* the residual claimants. Second, the continuous, indispensable existence of residual claimants can be explained in terms of corporate purpose-setting: *someone* has to determine the ends toward which the corporation will act.[76] This, too, is part of a contractual bargain: the person who becomes a party to the constitutional documents agrees to accept a position as determiner of corporate purpose. Other creditors are not in that position, nor should they be, as long as the obligations they *are* entitled to are being met. Furthermore, in the case of for-profit corporations, the residual claimant is also the indirect economic bene-

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[73] That is, law external to corporate law. In this sense, general law also includes bankruptcy law, which often dictates where corporations' assets go when their lives end. For discussion of the relation between general law and corporate law, *see infra* notes 77, 142.

[74] The residual might be negative. In non-limited liability corporations, the analysis remains the same: residual claimants are entitled to receive the residual, which happens to mean they will be burdened with new obligations, rather than acquiring new rights. In limited liability corporations, when the residual is negative, residual claimants are legally entitled to forego it.

[75] *See supra* note 5 (noting that constitutional documents must specify the names of the first shareholders). With the transferability of shares, the residual claim passes on to each subsequent shareholder.

[76] This is done when a promoter (and soon-to-be residual claimant) selects a certain form of incorporation, with a known, fixed purpose (a for-profit, nonprofit, or mixed-purpose corporation), *see infra* note 142. Additionally, and subject to that fixed purpose, the residual claimant specifies the corporation's goals in its constitutional documents, *see supra* note 5.

ficiary of pursuing those ends. From a deontological viewpoint, as long as the rights of no one else are violated,[77] there is nothing wrong with having a person determine the corporation's purpose and goals and indirectly enjoy their attainment.

In a sense, a natural person can also be said to have, at any given moment, "residual claimants": the person's presumptive heirs. They, too, are entitled to receive the future decedent's "net worth" (as their claim ranks below that of creditors) when the decedent's life ends. However, a natural person is different from a corporation in this regard, since heirs have no right to control the affairs of the future decedent *inter vivos*. This results from an important ex-

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[77] Indeed, by definition, residual claimants cannot bypass, or impair the rights of, non-residual creditors. Residual claimants *always* rank below creditors in the priority order of claims for the corporation's assets. The corporation must fulfill, or at least be able to fulfill, all of its obligations to creditors, before it is legally allowed to hand out any economic benefit to its residual claimants. Furthermore, residual claimants themselves cannot validly do anything (such as adopting a resolution in the shareholder meeting) that unilaterally impairs the content of the corporation's obligation to a creditor. These facts stem from the very concept of residuality. They are also protected by mandatory provisions of positive law, including general law (requiring every corporation, as any other person, to meet its obligations), bankruptcy law (placing residual claimants at the lowest level of priority, dictating that if the corporation's obligations to creditors are not fully met, residual claimants are not entitled to any value) and corporate law, *see, e.g.*, DGCL §§ 160(a), 170–174 (establishing mandatory rules to determine when a corporation is allowed to make a distribution to its shareholders, requiring that distributions not "impair" the corporation's capital, or that they be made out of the corporation's profits); Israel Companies Act §§ 301–305, 307, 309–313 (establishing mandatory rules to determine when a company is allowed to make a distribution to its shareholders, requiring, without exception, that it maintain its ability to meet all obligations to creditors). *See also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 11 (1991) ("Equity investors are paid last, after debt investors, employees, and other investors . . . . These equity investors have the "residual" claim in the sense that they get only what is left over . . . ."). *But see, e.g.*, Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L. J. 1870, 1928–29 (2017) (criticizing that understanding of the relation between residual and non-residual claims). However, that part of Chief Justice Strine's article far from negates the concept of residual claimancy. First, it conjures up an image of an "ultimate reckoning of accounts," *id.* at 1929, on which residuality presumably depends, while overlooking the many concrete, continuously binding norms, some mentioned above, that support the priority of non-residual creditors. Second, it points to problems with the *enforcement* of law in this area, not with its substantive content. Certainly, it is *possible* to break the law, for example by transferring wealth to shareholders while obligations to creditors are not being met. Yet, no one has a *right* to do so. Similarly, a breach of contract does not modify the rules of contract law. Courts and other enforcement mechanisms exist in order to prevent and address such violations, in corporate law as in any other area.

tra-legal, philosophical distinction: a natural person is an end in himself, free to determine his own fate and life purposes. In contrast, a corporation exists to pursue some purpose and goals determined for it by others. Of course, due to the limits of the corporation's physical nature, there is simply no way it *could* determine its own purpose and goals without other people, and the choices they make. This does not undermine the corporation's existence as a separate person; it just means that an artificial person's life purpose is chosen in a different manner than that of a natural person. Moreover, the fixing of purpose, at the corporation's "birth," does not change the fact that the corporation, through its fiduciaries (and usually *not* its residual claimants), has extremely wide latitude in choosing its course of action, or "way of life," within that purpose.[78]

The logical chain laid out above leads to the inevitable existence of residual claimants, in respect to every corporation. Depending on the type of corporation, residual claimants can have many names, such as "partners" or "members." In some corporations, residual claimants are comprised of, and identical to, some other group of creditors, as in "mutual insurance companies," where policyholders are also the residual claimants.[79] In modern corporations, residual claimants are mostly known as "shareholders"—persons who own a "share." Like other securities, a share is a "thing," an object toward which property rights exist; a share has owners. It can also be rented, pledged as collateral, and so on. Simultaneously, the share itself is a bundle of rights:[80] it confers on its owner some obligatory *rights*, while attaching some *obligations* to at least one other person. The economic magnitude of these rights and obligations is equal to the residual interests of the cor-

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78 *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("[Directors'] broad mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability.").

79 *See, e.g.*, *2017 Annual Report*, EQUITABLE LIFE INSURANCE COMPANY OF CANADA 15 (Feb. 13, 2018), https://cdn.equitable.ca/forms/unsecured/insurance/2017-Annual-Report.pdf [https://perma.cc/EU4P-4FYA] (showing "policyholders' equity" as the only type of equity in the balance sheet). Practically, this means that the residual claimants have a dual contract with the corporation, giving rise to claims under both general (contract and insurance) law and corporate law, including equitable claims as discussed in this Article.

80 *See* Israel Companies Act § 1 (defining "Share" as "a bundle of rights in the company that are determined in law and in the article of incorporation[.]").

poration—those left after all corporate obligations, of any kind, to all non-residual claimants are satisfied, in practice or in capacity.[81]

Most importantly, the related concepts of "share" and "residuality" create a long, open list of unique problems. This stems from the unusual, not easily explicable nature of residual obligations—mainly, the inherent lack of any contractual or other legal mechanism to determine what the shareholders' claim is, except for the phrase "what is left after all obligations to other creditors are satisfied." That phrase might seem straightforward, but it is not. Shareholders' claims are intricately tied to another person's acts, omissions, successes and failures. They ebb and flow with the corporation's fortunes. This situation has no parallels in other legal fields. In contract and property law, for instance, the claimant has a claim toward something grounded in external reality, such as concepts of money, time and place. An obligor might breach an obligation, but these concepts exist independently of him. This makes it comparatively easy for the claimant to ascertain and demand what is owed, for example, "one hundred dollars." In contrast, shareholders can never accurately know the extent of their claims, both because of information and power asymmetries to their detriment, and because many things, some wildly unexpected, might happen to the corporation, or within the various relationships arising from the share (shareholder-corporation, shareholder-shareholder and shareholder-third party). Therefore, "the claim attached to one percent of the corporation's outstanding shares," or what *should* be considered as that claim, is far more complex and problematic than "one hundred dollars."[82]

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[81] Residuality characterizes shares by default. "Regular" residual claim shares are often known as "common shares." There also exist types of securities, sometimes called "preferred shares" (although they can have many other names and properties), that carry some contractual terms endowing their owners with non-residual, or a combination of residual and non-residual, claims. Their owners may, in fact, be regular creditors. *See infra* pp. 280–81 (discussing preferred shares). This situation also occurs in U.S. mutual funds, where shareholders do not own a residual claim share; rather, they own trust law claims toward a corporate trustee and a defined pool, or segment, of its assets. That definition, often in terms of a certain investment strategy, appears in the contractual documents creating each class of "shares."

[82] These problems attach to the concept of shares at a very preliminary level. For example, the number of outstanding shares is a *starting* point in any determination of shareholder rights in a corporation. It gives meaning to the content of a single share, by establishing the relation between it and the entirety of shareholders' claims. However, a shareholder might not even be able to reach that point easily enough. It is possible that shareholders will have no knowledge of the real number of outstanding shares a corporation has at a given moment, due to some

This unclarity leads to an extraordinary range of possible situations. Some of these are between the corporation and its shareholders: for example, in the case of no dividend being distributed for a long time; no *legal* right exists to demand distribution.[83] Some problems are among shareholders themselves, as in the case of a dilutive allocation of new shares, which is an indirect transfer of wealth from current to new shareholders; general contract law nowhere contemplates this situation.[84] Some problems are between shareholders and third parties, as in the case of harm done to the corporation, and indirectly to shareholders' claims toward it, which for some reason cannot be corrected with legal action taken by the corporation itself.[85] Another example is harm done to the

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administrative error or an information gap (such as a private allocation of shares to a new shareholder, not timely and correctly reported to current shareholders, for any reason). Israeli law partly attempts to address this situation, *see* Securities Regulation (Private Offering of Securities in a Registered Company), 5760-2000, §§ 2, 21, KT 6051 p. 834 (Isr.) (requiring approval by the stock exchange and a public disclosure of the details of any private offering of shares by a public company). This provision is meant to prevent information gaps, so that all shareholders know of changes in the number of outstanding shares, including those resulting from a non-public allocation. However, this regulation, like any other, can be breached, intentionally or not. This possibility illuminates the crucial difference between shares and non-share claims, as the latter are grounded in concepts (such as sums of money) independent of the corporation.

[83] Yet, corporate law recognizes and may provide remedy against an inequitable withholding of dividends. *See, e.g.*, Hunter v. Roberts, Throp & Co., 47 N.W. 131, 134 (Mich. 1890) ("Courts of equity will not interfere in the management of the directors unless . . . they . . . refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders."), *quoted in* Dodge v. Ford Motor Co., 170 N.W. 668, 682 (Mich. 1919). More generally, "the court of equity is at all times open to complaining shareholders having a just grievance." *Id.* at 684.

[84] Yet, corporate law recognizes and may provide remedy against inequitable dilution. *See, e.g.*, Gentile v. Rossette, 906 A.2d 91 (Del. 2006) (holding that former minority shareholders, deprived of value by a debt conversion transaction, can bring a direct claim against the former controlling shareholder; also holding that in various circumstances, share dilution can give rise to both derivative and direct claims); Feldman v. Cutaia, 956 A.2d 644, 655 (Del. Ch. 2007) ("A claim for wrongful equity dilution is premised on the notion that the corporation, by issuing additional equity for insufficient consideration, made the complaining stockholder's stake less valuable."); CA 667/76 L. Glickman Ltd. v. A. M. Barkai Inv. Co. Ltd. 32(2) PD 281 (1978) (Isr.), https://www.nevo.co.il/psika_html/elyon/LA-2-281-L.htm [https://perma.cc/S8FL-P9SK] (affirming grant of injunctive relief to minority shareholders, following a large allocation of new shares for consideration below their real value).

ability of the corporation to distribute rights to its shareholders, as with limitations on dividends in the financial sector.[86] In some situations, the third party might be the corporation's creditors, as in the case of an unlawful distribution, or in non-limited liability corporations. The third party might also be the corporation's fiduciaries (directly, not derivatively), such as when the corporation is in *Revlon* mode.[87] Yet another group of such issues concerns those third parties involved in facilitating the corporation-shareholder link, such as banks, brokers, custodians, depositories, nominee companies, and stock exchanges, without the proper services of whom most shareholders would never practically enjoy their rights.

These issues need to be dealt with in a methodic manner, based on some unifying, underlying principles, as good law must strive to do. Together, they comprise the field of share law.

4. THE STARTING POINT: SIMPLISTIC PERCEPTIONS OF SHARES

Yet, the amount of methodic treatment given to share law, especially compared to corporate fiduciary law, is surprisingly minimal. One omnipresent problem is under-definition. In the Delaware General Corporation Law, no definition appears of the terms

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85 Yet, corporate law recognizes the derivative action, brought on behalf of a corporation by a shareholder. *See infra* note 159.

86 *See, e.g.*, BASEL COMM. ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (2010), https://www.bis.org/publ/bcbs189.pdf [https://perma.cc/99R6-Q968] (establishing guidelines for implementation by national regulators, regarding, among other things, limitations on banks' and similar financial institutions' ability to distribute capital to shareholders). This exemplifies a situation where the interests of the corporation, as well as its fiduciaries, are not aligned with those of shareholders. The corporation and its fiduciaries get a "good excuse" to keep and control more assets, rather than distribute them. Hence, they might be more aligned with the third party (the regulator) who imposes the limitation. Conceivably, legislatures and other regulators can mandate any extreme limitation, even barring distributions altogether. They might do so in regard to any corporation, not just financial services providers. This illustrates an equity situation, where no "legal" right exists (to be entitled to distribution), yet, an outcome where shareholders are completely separated from their investment is clearly unjustifiable. Shareholders might be able to challenge this type of regulation. Their claim would be direct, not derivative. Such a challenge would require (on multiple fronts, from procedural standing to substantive arguments) a well-grounded explanation of shares and shareholder rights. That explanation is provided in share law.

87 *See infra* pp. 298–300.

"share" or "stock." This may be attributed to the lack of an introductory definitions section in that statute, but it is also the result of a deeper issue: that we think of the concept of a share as something "taken for granted," requiring little analysis because we do not really need to know what it is. Supposedly, the share is a black box. We easily and offhandedly identify its "outputs," such as dividends and voting rights, but we have no well-crafted idea of the process that generates these particular outputs. The Delaware statute is replete with no less than 662 mentions of the terms "shareholder" and "stockholder",[88] granting them a central role in many statutory provisions, without ever defining who they are or what they possess. The American Law Institute's Principles of Corporate Governance exemplify this problem even more strongly, with an empty definition of an "Equity security" as "a share . . . or . . . a security convertible [into a share.]"[89] The reader is left not knowing what a share, nor an equity security, actually is. The Israel Companies Act fares slightly better, when it defines a share as "a bundle of rights in the company that are determined in law and in the article of incorporation[.]"[90] This, first, identifies the basic nature of shares: they are rights (and not, say, contracts). Second, it creates a link between the share and another concept, the constitutional documents, so shares can arise only from that particular contract. If a security is not mentioned there, it is definitely not a share.[91] Yet, the statute fails to explain what are rights "in" another person (indeed, that phrase is meaningless[92]), or what prevents a corporation from also specifying the details of non-share obligations in its constitutional documents (indeed, nothing does).

Another example of this simplistic approach lies in how naturally we view the trading, on the same exchange floor, of shares issued by corporations that are incorporated in very different jurisdictions, or even legal traditions (civil and common law). The New

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[88] *See* DGCL (search for the phrases "shareholder" and "stockholder" over the entire document).

[89] PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 1.20 (AM. LAW INST. 1994).

[90] Israel Companies Act § 1.

[91] This is further embodied in the mandatory requirement that the authorized capital, which is the maximum number of shares the corporation can issue of each class, shall be specified in the article of incorporation. *See* Israel Companies Act §§ 18(3), 33, 34. Therefore, if a security is not mentioned, in the article of incorporation, as having a certain authorized capital, it is definitely not a share.

[92] *See infra* Part 5.2.

York Stock Exchange lists equity securities issued by corporations from China,[93] Germany,[94] Israel[95] and the U.S.,[96] among many others, and they live unsuspiciously together. We perceive them just as "shares," rarely stopping to examine their insides. The corporate laws of these different places might treat shares in disparate ways. Such differences can be important in multiple respects. For example, only if a corporation has issued shares, not other securities, to the public, does it become a "public company,"[97] with all the massive legal ramifications that category entails. Being a "share," not something else, carries many other consequences, in a manner that often takes for granted the ability to differentiate between shares and non-share obligations.[98]

Even when we do try to discern shares from other legal phenomena, a common method is to discuss them in terms of a *list of rights*, or the benefits with which they *usually* endow their owners.[99] That list might include dividends, liquidation proceeds, merger proceeds, voting, access to certain information, and perhaps some court actions.[100] However, first, this list is both short and not always correct. It can be contracted around, leaving the security owners with more rights or less, or highly modified ones;

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93 *See, e.g.*, *Alibaba Group Holding Limited American Depositary Shares Each Representing One Ordinary Share (BABA)*, NYSE, https://www.nyse.com/quote/XNYS:BABA [https://perma.cc/6PRH-CGUM] (last visited Oct. 26, 2018).

94 *See, e.g.*, *SAP SE ADS (SAP)*, NYSE, https://www.nyse.com/quote/XNYS:SAP [https://perma.cc/M8JQ-JPM9] (last visited Oct. 26, 2018).

95 *See, e.g.*, *Teva Pharmaceutical Industries Limited American Depositary Shares (TEVA)*, NYSE, https://www.nyse.com/quote/XNYS:TEVA [https://perma.cc/SZK4-Z872] (last visited Oct. 26, 2018).

96 *See, e.g.*, *International Business Machines Corporation (IBM)*, NYSE, https://www.nyse.com/quote/XNYS:IBM [https://perma.cc/9ZS7-KYXM] (last visited Oct. 26, 2018).

97 *See, e.g.*, Israel Companies Act § 1 (defining "Public company" as "a company whose shares are listed on an exchange or were offered to the public . . . and are held by the public[.]").

98 *See, e.g.*, *supra* note 88 and accompanying text.

99 *See, e.g.*, ALLEN & KRAAKMAN, *supra* note 63, at 146 (introducing shares as distinct from debt securities, by focusing on two rights, voting and dividends: "Common stockholders elect the board. After the company has paid its expenses . . . and [paid its debts to creditors], whatever is left over can loosely be said to "belong" to the stockholders in the sense that it is available for the payment of dividends.").

100 *See, e.g.*, Israel Companies Act §§ 183–191, 194(a), 320–321; Israel Companies Ordinance §§ 284, 330(1) (detailing various rights granted to shareholders).

they might still be shareholders. A good example is preferred shares. The term "preferred share" denotes a family of securities that straddle the line between actual shares and other securities, namely bonds. A preferred share, despite its name, might not be a "share" in any substantive sense. Even when it is, its content is often markedly different than that of other securities called "shares;" for example, it might not carry any voting rights. How do we tell if something is a share or not?[101] How do we determine the legal treatment that should be given to a particular security? These questions are part of share law, and its interaction with broader concepts of corporate and private law. General, simplistic views of shares do not suffice to explain preferreds, or to fully and fairly determine the rights of their owners—problems that recent scholarship has grappled with.[102]

Second, the "list of rights" approach fails to note an important fact: a given corporation might not experience any rights distribution event (such as a dividend or liquidation) for an extremely long time—in fact, a potentially *unlimited* period—yet, shares of that corporation will have intrinsic value and people will buy and sell them, for a price, at the secondary market. This is in contrast to other kinds of obligations, which do have a maturity date, or otherwise limited lifetime. It is clear why bonds have value: their owners have a contractual right to receive known sums of money at known times. Shares carry no such rights; in fact, it is hard to ascertain from any textual source (contract or law) what *is* the economic content a share carries throughout its existence. So, why do shares have value? What is their intrinsic content? What claims does a shareholder have, and toward what or whom?

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101 A question of great practical importance, due to, *inter alia*, the special status that corporate law confers upon shareholders and not others, often by mere reference to the word "share" or "shareholder," presupposing the ability to differentiate between shares and other securities. *See supra* note 88 and accompanying text (noting that the DGCL mentions the terms "shareholder" and "stockholder" 662 times, without defining shares).

102 *Compare* William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815 (2013), *with* Leo E. Strine, Jr., *Response: Poor Pitiful or Potently Powerful Preferred?*, 161 U. PA. L. REV. 2025 (2013) (articles presenting different views regarding the nature of preferred shareholders' rights, on a spectrum between equitable rights, similar to those attached to common shares, and contractual rights, similar to those attached to non-share corporate obligations).

5. FOUR UNSATISFACTORY APPROACHES TO SHARES

These questions are traditionally answered using several approaches (that is, beyond the simplistic "black box" and "list of rights" approaches outlined above). As the discussion below reveals, even these more developed approaches only examine the topic via their own, entrenched perceptions. Some offer correct observations, but none is free of inaccuracies; none can serve as the basis for a theory and law of shares. This Part surveys the four main approaches invoked today to explain the share phenomenon. As a unifying theme, it asks how the *Co-Op* decision might be justified, if at all, under each approach.

5.1. The Contract Approach

According to one common approach, shareholders are just a group of creditors, who have paid large sums of money[103] to enter into a contract (the constitutional documents) which in itself is devoid of meaningful content. It includes no maturity date, no periodic payments, no financial covenants, and no right to sue under general contract law even when the corporation is running badly and the chances of getting a return become slim.[104] It is a contract for a *residual* claim, with all the attendant problems.[105] This approach views shareholders as contractual parties, but with a largely unwritten,[106] custom-based or implied covenant-based con-

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103 *See supra* note 2. The amounts mentioned there are on a global scale, but they are composed of the holdings of many separate shareholders, each the owner of substantive rights that should be protected by legal norms and institutions, as any other right.

104 In non-limited liability corporations, shareholders bear an even bigger risk: ending up with shares of negative value, due to having to satisfy part or all of the corporation's liabilities themselves. *See supra* note 74. Non-residual creditors do not bear such a risk; if insolvency occurs, they stand to lose, at most, their own claim. This further demonstrates the unique position of shareholders, compared to all other creditors.

105 *See supra* Part 3.

106 *See, e.g.*, Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1451 (1989) ("Complications arise in corporate transactions, however, because the relevant "agreement" is generally unwritten, frequently ambiguous or contradictory and often not an agreement at all."). *See also supra* notes 5, 6.

tract[107] and with legal rights disproportionate to their economic investment. They are creditors having none of the protections of contract law.

On the other hand, they might incur the downsides: in *Co-Op*, one could argue that the unknown shareholders have "abandoned" or "slept on" their rights, which under contract law doctrine, is possibly sufficient to negate those rights.[108]

Furthermore, contract law generally provides a rich, well-developed doctrinal environment; a good example is the availability of remedy against an *anticipatory* breach of contract.[109] However, contract law is largely built on the assumption that creditors know, or *can* know (and prove), what they are entitled to. For shareholders, no remedy against "anticipatory breach" is possible, because the shareholder has nothing specific enough to anticipate.

Another important doctrinal problem is that under contract law, "the drafting burden [is] on the party asserting the right[.]"[110] Hence, it could have been claimed that the unknown shareholders should have had, in Co-Op's constitutional documents, express clauses saying that they hold quasi-property rights, unlimited in time, toward the corporation's net worth; and regulating many other situations that might occur, no matter how remote. Such clauses are practically not found in any constitutional documents. Similarly lurking are statute of limitations arguments, which cannot be raised as easily against owners of property or quasi-property (equity) rights.[111]

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107 Although the contract approach itself might not necessarily say so, equity is the main source of the customs and implied covenants embodied in shares. *See infra* Part 6.

108 *See, e.g.*, DEL. CODE ANN. tit. 6, § 2-309(1) (2018) ("The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time."); Contracts Act (General Part), 5733-1973, § 41, SH No. 694 p. 118 (Isr.) [hereinafter: Israel Contracts Act] ("If no time has been agreed on for the fulfillment of an obligation, it has to be fulfilled a reasonable period after the formation of the contract, at a time of which the creditor has given notice to the debtor a reasonable period in advance.").

109 *See, e.g.*, DEL. CODE ANN. tit. 6, § 2-610 (2018) ("When either party repudiates the contract with respect to a performance not yet due . . . , the aggrieved party may . . . resort to any remedy for breach . . . ."); Contracts Act (Remedies for Breach of Contract), 5731-1970, § 17, SH No. 610 p. 16 (Isr.) ("If a party indicates its intention not to perform a contract, or if it appears from the circumstances that [the party] will be unable or unwilling to perform [the contract], the other party is entitled to remedies according to this Act even before the date set for the performance of the contract . . . .").

110 Bratton & Wachter, *supra* note 102, at 1820.

111 *See, e.g.*, Peter Watts, *Some Aspects of the Intersection of the Law of Agency*

To a large extent, the contractual approach is associated with the school of law and economics and the "nexus of contracts" theory. Under these disciplines, a contract is simply a contract; one contract may differ from another in terms, but not in general nature. Hence, shareholders are presumably just another group of stakeholders in the corporate nexus.[112] It is worth noting that according to the nexus of contracts theory, the corporation itself is an aggregation of contracts.[113] However, that statement is wrong. How can "a contract" (or any number thereof) sue someone in court, own property, or do anything else? More correctly, the corporation is a person; it is not *the* nexus of contracts, but the central *party* to the nexus of contracts.[114]

Of the four approaches discussed in this Part of the Article, the contract approach, equally with the trust approach,[115] is probably the least wrong when it comes to shares. The share relationship is, at a basic level, a contractual relationship between shareholder and corporation.[116] When a person owns a share, that person primarily

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with the Law of Trusts, *in* EQUITY, TRUSTS AND COMMERCE 29, 45 (Paul S Davies & James Penner eds., 2017) ("In many jurisdictions, limitation periods do not apply to actions for failure to account brought against an express trustee.").

112 *See, e.g.*, HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 15 (1996) ("[S]upplying capital to the firm is simply one of many transactional relationships to which ownership can be tied, and there is nothing very special about it."); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 274 n.8 (1986) ("There is no fundamental difference between debt and equity claims from an economic perspective."). The answer to this line of argument is that, although non-residual creditors might sometimes lose part or all of their positive law claim, this does not modify the claim's intrinsic content, which is not residual, is often fixed, is represented by some concepts (such as money and time) external to the corporation, and is governed by some normative framework external to corporate law. For creditors, what fluctuates is not their claim's content, but the *probability* of receiving it. Creditors' rights may be negated when the corporation becomes insolvent, which is the exception; most corporations are not insolvent. The content of creditors' claims can change only according to external law, such as contract or bankruptcy law. The rule, and the general perception of being a "creditor," is that creditors have a relatively stable claim, and they usually get it. In contrast, residual claimants' positive law claim is *intrinsically* non-fixed and entirely dependent on the corporation. Their claim is *always* fluctuating, even when the corporation is not insolvent, and even if it is very successful. Therefore, shareholders are indeed special and different than non-residual creditors.

113 *See, e.g.*, Henry N. Butler, *Corporation-Specific Anti-Takeover Statutes and the Market for Corporate Charters*, 1988 WIS. L. REV. 365, 369 (1988) ("The corporation is a nexus of contracts.").

114 *See infra* Part 5.2.

115 *See infra* Part 5.3.

116 In addition to the other relationships arising from shares: the shareholder-

owns a claim toward a corporation. However, by design, that claim is exceptionally vague and ill-defined. It is never put well into words—neither in contract, nor in law. It is far removed from the concept of a contract as we normally think of it. As a result, whenever we discuss the contractual approach, we must remember that the "share contract" is singularly exceptional, among all the corporation's relationships. It should never be described in terms of contract law alone. Rather, it is intertwined with another normative framework—equity. Part 6 of this Article expands on that distinction.

5.2. The Property Approach

At the other end of the spectrum, some have argued that shareholders "own" the corporation,[117] or are the true owners of the corporation's assets.[118] This approach is related to the "aggregate theory" of the corporation, which contends that a corporation is just a grouping of other individuals, usually its shareholders.[119]

Property rights are eternal; they do not have a maturity date. Under this approach, the result in *Co-Op* may be justified: property rights cannot be taken away, absent some exceptional circumstances, even if their owner fails to demand those rights or show

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shareholder and shareholder-third party relationships. *See supra* pp. 277–78.

117 *See, e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–65 (1992) ("In the first conception, the corporation is seen as the private property of its stockholder-owners."); Katsuhito Iwai, *Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583, 592 (1999) ("[W]hat does a corporate shareholder own? The corporation, of course. It is the corporation itself as a "thing" that a corporate shareholder legally owns. A corporate shareholder is literally a holder of a corporate share, a bundle of participatory and pecuniary rights in the corporation.").

118 *See, e.g.*, VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS OTHER THAN CHARITABLE 2 (1882) ("[T]he rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being."), *quoted in* Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1458 (1987).

119 *See, e.g.*, Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 42 (2000) ("The aggregate or partnership model of the corporation, which was prevalent in the 19th century, assumed [a role as the "owners" of the corporate enterprise] for shareholders . . . ." (citation omitted)). On the aggregate theory, *see generally* Sanford A. Schane, *The Corporation is a Person: The Language of a Legal Fiction*, 61 TUL. L. REV. 563, 566 (1987).

up in court to defend them. Certainly, they can be eliminated much less easily than purely obligatory rights.

However, the property approach is also mistaken. A corporation is a person.[120] It exists separately from any other person, including its shareholders. Like other persons, a corporation can enter into obligatory relationships and can *own* property. A corporation is not and cannot *be* property. Shareholders do not own the corporation; they own shares.[121] While it is meaningful to discuss the ownership of a *right toward* a corporation, it is unclear what might it mean, in both philosophical and property law terms, to "own" a corporation—another person, with interests and volition of its own.[122] Furthermore, the corporation is the full owner of its own assets,[123] including that portion amounting to its net worth

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[120] *See, e.g.*, DGCL § 122 (detailing a list of "powers" held by every Delaware corporation, generally similar and often identical to the capacities of a natural person); Israel Companies Act § 4 ("A company is a legal person capable of any right, duty and act that is consistent with its character and nature as an incorporated body."); Hawes v. Oakland, 104 U.S. 450, 453–54 (1882) ("This corporation, like others, is created a body politic and corporate . . . . [It] may make contracts, commit torts, and incur liabilities, and may sue or be sued in [its] corporate name in regard to all of these transactions. The parties who deal with [the corporation] understand this, and that they are dealing with a body which has these rights and is subject to these obligations, and they do not deal with or count upon a liability to the stockholder whom they do not know and with whom they have no privity of contract or other relation."); Salomon v. A. Salomon & Co. [1897] AC 22 (HL) 30 (appeal taken from Eng.) ("[O]nce the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself . . . ."); MODEL BUS. CORP. ACT § 3.02 (AM. BAR ASS'N 2016) ("Unless its articles of incorporation provide otherwise, every corporation has perpetual duration and succession in its corporate name and has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs . . . ."); ALLEN & KRAAKMAN, *supra* note 63, at 77 ("The corporation is considered a separate person in the eyes of the law."); John C. Coates IV, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 818–35 (1989) (discussing in detail the "natural entity theory" of the corporation); Schane, *supra* note 119, at 592–609 (providing legal and linguistic analysis of the concept of corporate personality).

[121] *See, e.g.*, YEDIDIA Z. STERN, HA'BA'ALUT BA'HEVRAH HA'ISKIT: TE'ORYAH, DIN, METSI'UT [THE OWNERSHIP OF A CORPORATION: THEORY, LAW, REALITY] 129 (2008) ("Shareholders, as their name also attests, hold a right of ownership in a share and not a right of ownership in the company.").

[122] *See id.* at 136 ("The company is an entity with interests of its own, that differ from those of any other actor . . . . The company is meant to act independently of any other entity to promote those interests."); *infra* note 145 and accompanying text.

[123] *See, e.g.*, DGCL § 122(4) ("[Every corporation created under this chapter shall have power to] [p]urchase, receive, take by grant, gift, devise, bequest or otherwise, lease, or otherwise acquire, own, hold, improve, employ, use and otherwise deal in and with real or personal property, or any interest therein . . . [.]");

(shareholders' equity). Shareholders, as other creditors may do, have entered into a *contract*, not a possessory relationship, with the corporation.[124] That contract is the constitutional documents, along with the legal and equitable norms they necessarily absorb. In summary, a corporation is not property, and its own property belongs to it, not to its shareholders. Therefore, a property approach to the nature of shares cannot hold.

5.3. The Trust Approach

The trust approach would turn to trust law, viewing the corporation[125] as a trustee, where shareholders are the beneficiaries and the corporation's net worth is the trust property. Seemingly exemplifying this approach is A. A. Berle's famous 1931 article.[126]

If this approach is correct, the *Co-Op* decision can be rather easily explained: shareholders have a trust claim toward their fractions of the corporation's net worth; that claim, somewhat similar to a property right as discussed above,[127] does not have a maturity date (unless otherwise specified in the terms of the trust; there was no such stipulation in Co-Op's constitutional documents), so shareholders own a right that is unlimited in time.

Once again, upon closer inspection, both trust law and corporate law do not support this approach. First, trust law is conservative. It is geared toward different purposes than corporate law. By default, the trustee has to maintain the trust property,[128] not engage

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MODEL BUS. CORP. ACT § 3.02(d) (AM. BAR ASS'N 2016) ("[Every corporation has power] to purchase, receive, lease, or otherwise acquire, and own, hold, improve, use, and otherwise deal with, real or personal property, or any legal or equitable interest in property . . . [.]"). The same proposition is implicit in Israel Companies Act § 4. In addition, references to the company's own property are spread throughout that statute, which also never mentions any proprietary link between shareholders and the company's assets.

124 *See supra* notes 4, 72.

125 In a different variation, the corporation's directors are the trustees or fiduciaries for shareholders. That approach may equally be refuted, *see infra* Part 5.4.

126 *See* A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (arguing that "all powers granted to a corporation . . . are . . . exercisable only for the . . . benefit of . . . shareholders", and that this is analogous to limitations on the power of trustees).

127 *See supra* Part 5.2.

128 *See, e.g.*, DEL. CODE ANN. tit. 12, § 3302 (2018) (instructing trustees as to "authorized investments"); Trust Act, 5739-1979, § 6, SH No. 941 p. 128 (Isr.)

in complex, risky activities, typical of the modern corporation. A chief consideration in trust law is the welfare of the beneficiary. In corporate law, shareholders are important, but their interests are not nearly as overriding as those of trust beneficiaries.

Second, a trust is a narrowly and strictly articulated concept. For example, in Israel, it is defined as "a relation to an asset according to which a trustee has to hold or act upon it for the benefit of a beneficiary or for another goal."[129] The "asset"—some piece of property—is a key component of any trust. Indeed, trust law is property-oriented, but the modern corporation is not simply a keeper of assets. It is an active and dynamic person, engaging in a host of acts that are often unrelated to safeguarding shareholders' investment. For example, when SpaceX develops a new type of Mars-going rocket,[130] besides being a risky use of corporate funds (related to the first point above), it is also an activity that has absolutely nothing to do with the work of a trustee. Abiding by the narrow strictures of trust law would not have allowed many modern corporations to exist, and would hinder the interests of both corporations and shareholders.[131]

Third, there is little support in positive law to the concept of the corporation being a trustee for shareholders. A survey of the corporate statutes of Israel, Delaware, the MBCA, and the U.K. reveals that none of them offer such a proposition. Furthermore, courts have repeatedly held that the corporation is not a fiduciary for its shareholders.[132] Since a trustee is one type of fiduciary,[133] it

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[hereinafter: Israel Trust Act] ("Those trust funds that are not required for [the trust's] ongoing needs, the trustee is obliged to *hold* or invest as is efficient *to maintain the principal* and make returns . . . ." (emphases added)).

129 Israel Trust Act § 1.

130 *See, e.g.*, Stephen Clark, *Musk: Atmospheric tests of interplanetary spaceship could happen next year*, SPACEFLIGHT NOW (Mar. 13, 2018), https://spaceflightnow.com/2018/03/13/musk-atmospheric-tests-of-interplanetary-spaceship-could-happen-next-year [https://perma.cc/9LJJ-P7VN]. Space Exploration Technologies Corp., also known as SpaceX, is a Delaware corporation. *See Division of Corporations - Filing*, DELAWARE.GOV, https://icis.corp.delaware.gov/ecorp/entitysearch/NameSearch.aspx [https://perma.cc/6GKQ-BNT4] (last visited Oct. 26, 2018) (search for entity name "Space Exploration Technologies Corp." or file number 3500808).

131 *Cf.* Kornhauser, *supra* note 106, at 1450 ("Unlike contract, which allows much discrimination in allocating entitlements among parties to the agreement, trust does not seem adequately flexible to explain the complex allocation of obligations and privileges among this web of actors.").

132 *See, e.g.*, *In re* Stillwater Capital Partners Inc. Litig., 851 F. Supp. 2d 556, 573 (S.D.N.Y. 2012) ("A corporation does not owe a fiduciary duty to its shareholders . . . ."); Alessi v. Beracha, 849 A.2d 939, 950 (Del. Ch. 2004) ("Earthgrains

is all the less plausible to see the corporation as shareholders' trustee.

Fourth and very pointedly, even when Berle wrote of shareholders' rights in trust, he did so by analogy. The analogy is to equity. Berle says so explicitly:

> [I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by *equitable rules somewhat analogous* to those which apply in favor of a [trust beneficiary] to the trustee's exercise of wide powers granted to him . . . .[134]

"Somewhat analogous" is far from "identical." In fact, throughout Berle's paper, "equity" and its inflections appear more frequently than "trust": 52 and 38 times, respectively.[135] Quite plainly, Berle meant to say that shareholders have *equitable*, or more-than-legal, more-than-contractual rights. The liberty Berle took in using "trust" for the title of his article is partly understandable, because trust law is a branch of equity. A right in trust is one, very common type of equitable right. Yet, as the discussion above illustrates, trust law is a specific area of jurisprudence, adding its own rules and conventions on top of those of general equity. Every corporation is an equitable obligor; not every corporation is a trustee.[136] The trust approach, like the contract approach, comes

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[(defendant corporation)] owes no fiduciary duty to Alessi [(plaintiff shareholder)]. I will not require Earthgrains to remedy Alessi's injury without a valid legal theory for holding Earthgrains liable.").

133 *See, e.g.*, *Trust Code Summary*, THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, http://uniformlaws.org/ActSummary.aspx?title=Trust%20Code [https://perma.cc/P4MD-J57Y] (last visited Oct. 26, 2018) ("A trustee is a fiduciary, sometimes described as the utmost fiduciary.").

134 Berle, *supra* note 126, at 1049 (emphasis added).

135 *See id.* (search for the phrases "equit" and "trust" over the entire document). Moreover, many uses of the word "trust" in Berle's article are as part of a name, such as "Fidelity Trust Company", *id.* at 1064, so the actual balance favors "equity" even more.

136 Of course, a corporation can also become a trustee, usually by entering into a trust contract. Some corporations, such as trust companies and money managers, are primarily devoted to such activity. The trust beneficiary is an equitable but non-residual creditor of the corporation. The beneficiary's rights are grounded in a field of law (trusts) that is external to corporate law, and they relate to some asset that is not entirely the product of the corporation's fortunes. On the distinction between residual claims and those grounded in external reality, *see supra* p. 276.

relatively close to the truth, but still requires qualification. Even when, as this Article urges, we adopt a broad, holistic view to protect substantive rights, precision is important.

5.4. *The Fiduciary Approach*

According to another approach, which presumably reflects most law in the United States, what shareholders own is a direct claim toward the corporation's fiduciaries. For example, a common reading of the famous *Dodge v. Ford* decision[137] implies that directors owe their duties not only to the corporation, but also *directly* to shareholders. No other group of creditors enjoys those duties. This can be taken to mean that shareholders and directors are parties to the same relationship, which gives rise to a heightened duty toward shareholders, co-existing with directors' duties toward another person—the corporation. Some Delaware cases seemingly imply the same.[138] This position accords with a pluralistic view of fiduciary law, which allows for the recognition of multiple, separate types of beneficiaries within the same fiduciary arrangement.

However, this approach, as well as the assertion that it reflects current American law, are both incorrect. First, even if it did mirror U.S. law, the pluralistic view is globally an exception. Other jurisdictions, including Israel,[139] the U.K.,[140] and most civil law Euro-

137 Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

138 *See, e.g.*, Cede & Co. v. Technicolor, 634 A.2d 345, 360 (Del. 1993) ("[D]irectors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders."); Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 979 (Del. Ch. 2000) ("Directors have an unyielding fiduciary duty to protect the interests of the corporation and the stockholders alike."). *But see infra* pp. 298–300 (explaining that the mergers and acquisitions context, where the cases mentioned in this footnote arose, is an exception partly allowing for direct duties toward shareholders).

139 *See* Israel Companies Act §§ 252(a) ("An officer owes toward the company a duty of care . . . ."), 254(a) ("An officer owes a duty of loyalty to the company . . . ."). The term "officer" includes a director, *see* Israel Companies Act § 1.

140 *See* Companies Act 2006 § 170(1) (UK) ("The general duties specified in sections 171 to 177 are owed by a director of a company to the company."). *See also* D. D. Prentice, *Directors, Creditors, and Shareholders*, *in* COMMERCIAL ASPECTS OF TRUSTS AND FIDUCIARY OBLIGATIONS 73, 73 (Ewan McKendrick ed., 1992) ("It is a generally accepted principle of company law that directors owe their duties to the company and not to the company's creditors or to its shareholders . . . .").

pean countries,[141] take the monistic view: directors and similar fiduciaries owe their duties only to the corporation. In turn, the corporation owes various obligations to others—contractual, tort, equitable, environmental, or any other kind. Like any person, the corporation is required to obey positive law, including share law, and meet its obligations. Yet, this has nothing to do with extending *fiduciaries'* duties, beyond their duty to the corporation.[142]

Second, from a normative standpoint, this approach is bad law. A core tenet of fiduciary law is that a fiduciary may not be the servant of two masters.[143] In other words, under fiduciary law, divided loyalty is breached loyalty.[144] The interests of the corporation and its shareholders can and do diverge.[145] Therefore, this du-

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141 *See* Klaus J. Hopt, *Directors' Duties to Shareholders, Employees, and Other Creditors: A View from the Continent*, *in* COMMERCIAL ASPECTS OF TRUSTS AND FIDUCIARY OBLIGATIONS 115, 116 (Ewan McKendrick ed., 1992) ("The general rule in most European countries is that directors have direct duties and liabilities only to their company.").

142 This can be stated in terms of corporate purpose: the for-profit corporation's purpose is the lawful pursuit of profit. *See, e.g.*, Israel Companies Act § 11 ("The purpose of a company is to act according to business considerations to maximize its profits . . . ."); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) ("I cannot accept as valid . . . a corporate policy that . . . seeks *not* to maximize the economic value of a for-profit Delaware corporation . . . ."). The "lawful" part is not mentioned in these sources, but it is obvious: everyone must obey positive law; even if a corporation wanted to have a non-lawful purpose, by definition, law cannot give cognizance to such an attempt. Directors and other fiduciaries are duty-bound to promote the achievement of the corporation's purpose. As pertains to the corporation's relationship with shareholders, this relates to both the "lawful" (the corporation must obey share law) and the "pursuit of profit." When fiduciaries cause the corporation to *not* operate this way, they steer the corporation away from its purpose and thus breach their duty to the corporation.

143 *See, e.g.*, *supra* note 68 (citing judicial decisions holding that a fiduciary is bound to act single-mindedly for the interests of the beneficiary); EASTERBROOK & FISCHEL, *supra* note 77, at 38 ("[A] manager told to serve two masters . . . has been freed of both and is answerable to neither.").

144 *See, e.g.*, LICHT, *supra* note 9, at 183 ("[T]he duty of loyalty can sustain only one interpretation—the monistic interpretation. A pluralistic approach and a duty of loyalty are contradictory in the most basic sense—definitionally, in fact—so an attempt to interpret and apply the duty according to this approach counters [the duty of loyalty's] principles and values. Such an attempt amounts to an elimination of the duty of loyalty . . . .").

145 The benefit of shareholders is closely related, but not identical, to the benefit of the corporation. The two may diverge in various situations, including the distribution of a dividend or a share buyback, the mergers and acquisitions context, or a decision on voluntary dissolution. This divergence was also examined in a well-known Delaware Court of Chancery opinion. *See* Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., 1991 Del. Ch. LEXIS 215, at *108 n.55 (Del. Ch. Dec. 30, 1991) (illustrating a situation where a corporation, its sharehold-

ality is neither desirable nor practicable.

Third, this approach is structurally flawed. Even if shareholders did enjoy direct duties owed by directors, that would not be of much help, because directors are not the owners of the corporation's assets; the corporation is. If, for any reason, the corporation loses a certain amount of wealth (an indirect loss for shareholders), that amount does not necessarily go into directors' pockets. This is particularly true when the loss results from a breach of the duty of care, rather than the duty of loyalty; or when it results from no fiduciary breach at all, but from the action of a third party, which directors could not practically have prevented. Moreover, the larger the amount, the less likely it is that directors (or their insurers) can or will fully compensate for it. In any case, the economic claim held by shareholders is toward the corporation and its net worth, not its directors and *their* net worth.

Fourth, this approach is also flawed from another structural perspective. Shareholders and directors are not parties to the same contract. Each director is party to a contract with the corporation, an "employment contract" of sorts, heavily laden with terms of fiduciary law (often unwritten and implied). These contracts are initially entered into when the corporation is created and its first directors embark upon their roles.[146] They are separate from another contract—the corporation's constitutional documents, also coming into force the moment the corporation is formed.[147] That contract is recognized, either by statute or case law,[148] to involve the corporation and its shareholders as parties. The one person who is party

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ers and its creditors each have a different interest as to the same business decision). This non-identity is further reflected in the difference between various "time frames" toward which the corporation may be oriented. The corporation may operate for its long-term benefit, or some other time horizon lawfully determined by its fiduciaries. *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("[Directors'] broad mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability. . . . [A]bsent a limited set of circumstances . . . , a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short term . . . ." (citation omitted)). While this should *also* benefit shareholders, as claimants toward the corporation and the residual of its wealth, it does so in a manner that might be objectionable to some, or even the majority of, shareholders. This is far from the pretense that the corporation and its shareholders are the same, have the same interests, or can be the object of the same duties.

[146] *See supra* note 72.

[147] *See, e.g.*, DGCL § 106; Israel Companies Act § 16 ("A company's article of incorporation . . . is in force from the time of its incorporation.").

[148] *See supra* notes 4, 72.

to *both* contracts is the corporation. This, too, makes plain that shareholders' rights come to them from the corporation.

Fifth, careful examination reveals that even *Dodge v. Ford* supports the monistic view: directors owe their duties only to the corporation. *Dodge v. Ford* never says that shareholders directly benefit from fiduciary duties,[149] but only that shareholders are special, compared to all other creditors. That is because "[a] business corporation is *organized* and *carried on* primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."[150] Clearly, the topic *Dodge v. Ford* entertains is *the purpose of the corporation*, not the identity of fiduciary law beneficiaries. The rights of shareholders are channeled through the corporation—they are a product of the existence and organization of the corporation. They do not directly flow from directors, whom *Dodge v. Ford* instructs as to carrying on the business *of the corporation*.

Even when not relying on *Dodge v. Ford*, for example in Delaware,[151] the "direct fiduciary" interpretation is misguided. Given the weight of positive and normative evidence against a fiduciary approach to shares, as presented in this section, decisions and other materials to such effect should be read accordingly. Where "duties to the corporation and its shareholders," or similar language, is employed, its correct construction is "duties to the corporation, who in turn owes to shareholders." This reading fully conforms with existing law, while correcting a certain imprecision, which tends to occur for several reasons. To begin with, shareholders' claim is *closely linked* to the corporation's well-being, which directors are duty-bound to advance. The more the corporation achieves *its* purpose, *usually* the greater the benefit of shareholders, assuming correct operation of share law. This close relation, between the welfare of residual claimants and that of the corporation, might easily motivate the inaccurate wording. Courts write as if the two are identical, so there is no "translation" process between them, and there is not much difference between saying "the corporation" and "its shareholders." As this Article demonstrates, that assumption is untrue. The relation is not an identity; equating the

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149 In fact, the word "fiduciary" is never mentioned in the decision. *See Dodge v. Ford*.

150 *Id.* at 507 (emphases added).

151 *See supra* note 138.

two is, at most, a general metaphor.[152]

The phrasing inaccuracy might also arise from the fact that shareholders' rights are grounded in equity-based share law, and equity is closely related to fiduciary law. In essence, courts are using "fiduciary" as code for "equity." They are trying to convey that shareholders are not regular, arm's length creditors, but equity claimants, with more-than-legal, more-than-contractual rights, justified by power and information asymmetries, similar to those found in fiduciary relationships. That is entirely accurate; yet, it does not turn shareholders into fiduciary law beneficiaries. Fiduciary law and equity are not synonymous. Different types of equity claimants exist.[153] This distinction has far-reaching practical implications. Fiduciary law is strict. With the duty of loyalty at its heart, it requires the fiduciary to self-abnegate and to treat all beneficiaries with the same, extremely high standard of conduct.[154] Loyalty is not a matter of degree. Equity, the taxonomical parent of fiduciary law, operates more broadly: it can inject flexibility where required. It enables us to fine-tune the concept of shareholders, recognizing they are separate from the corporation, and cannot be the object of the same duties, while also realizing they are different from non-residual creditors, and must be protected appropriately. In fact, Delaware law submits to this distinction. It concedes that direct duties, owed by directors to shareholders, are an *exception*, arising only in situations such as those invoking *Revlon* duties.[155] Moreover, the *Unocal* and *Revlon* standard of re-

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[152] *See, e.g.*, LICHT, *supra* note 9, at 199 ("[T]he [duty of loyalty] itself is toward the company. Shareholders are beneficiaries in a conceptual and indirect manner . . . ."); Paul L. Davies, *Directors' Fiduciary Duties and Individual Shareholders*, *in* COMMERCIAL ASPECTS OF TRUSTS AND FIDUCIARY OBLIGATIONS 83, 83–84 (Ewan McKendrick ed., 1992) (discussing "the doctrine that the duties of directors are owed to shareholders collectively" in a way that reveals no practical difference from duties "to the company"; further mentioning that "directors' duties . . . involve obligations owed . . . [to a] group not normally limited to the existing shareholders of the company", but also including future and "potential shareholders"—which confirms that the only actual, identifiable person, to whom those duties can run, is the company). *See also supra* note 145. A purpose-based formulation of corporate law can easily bridge this conceptual gap, by clarifying that the fiduciary's duty, toward the corporation, is to promote the achievement of the corporation's purpose, which is the lawful pursuit of profit, which in turn (by operation of share law) also benefits shareholders. *See supra* note 142.

[153] *See infra* pp. 303–05.

[154] *See supra* notes 68, 69, 144; *infra* pp. 304–05.

[155] *See infra* pp. 298–300.

view is an "intermediate standard"[156] of "enhanced scrutiny",[157] above the business judgment rule, but below the entire fairness required by the duty of loyalty.[158] This is precisely the flexibility afforded by equity, and forbidden under fiduciary law. Delaware itself, the seeming focal point of "direct fiduciary" language, in fact adopts a nuanced, equitable approach to share law.

Sixth, another proof that even the American (and specifically Delaware) view is monistic, as in other jurisdictions, comes from the distinction between derivative and direct actions. If directors owed directly to shareholders, or if the corporation's "middleman" status was otherwise eliminated, there would be no difference between harm to the corporation and harm to its shareholders. *Every* lawsuit against directors (or any other defendant, for that matter) could then be brought as a direct action, in the name of shareholders. In reality, the existence of, and insistence on, derivative actions demonstrate that only the corporation is the beneficiary of directors' duties. Shareholders may assert a breach of those duties only indirectly, on behalf of the corporation. Practically, this distinction is extremely consequential, as any plaintiff who tries to navigate the unique procedural hurdles of derivative litigation quickly learns.[159]

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156 *See* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 248 (1989) ("[T]he Delaware courts' most recent response to the tension between the intrinsic fairness standard and the business judgment standard in the takeover context [is a]n intermediate standard of review mandating that management's defensive tactics must be "reasonable in relation to the threat posed" by a hostile offer." (citation omitted)).

157 *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (discussing "the enhanced scrutiny which *Unocal* requires of director conduct."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("When a board addresses a pending takeover bid . . . there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.").

158 *See, e.g.*, Gilson & Kraakman, *supra* note 156, at 247 ("[T]he intrinsic fairness test[does] not seem adequate [(due to over-strictness)] when courts must evaluate defensive measures that implicate . . . [management's] loyalty to shareholder interests."). If management really owed to shareholders a full duty of loyalty, the same as it owes to the corporation, then according to fiduciary law principles, *see supra* notes 68, 69, 144, it would be impossible to diverge downwards from the entire fairness test. Clearly, then, that is not what management owes to shareholders.

159 For the rules governing the distinction between direct and derivative actions, and the pretrial stages of a derivative action in Delaware, *see* Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004) (holding that the distinction between derivative and direct claims turns solely on "who suffered the

Furthermore, not only shareholders can file derivative lawsuits; sometimes, creditors can do so as well.[160] In any case, the action is brought *on behalf of the corporation* and for *the corporation's* benefit. The fundamental idea behind *Gheewalla*[161] is that just like shareholders, if creditors are to be righted for a wrong they suffered, they have to address the corporation; their rights are channeled through the corporation; they do not have direct claims toward anyone else. The ultimate, indirect outcomes of fiduciary duties and their breach can be complex (such as harm to creditors, rather than or in addition to shareholders), but those duties are owed to the corporation, who is itself the distributor of wealth (or other legal effects) to both shareholders and creditors, and the object of claims by them.

Seventh, contrary to the common yet mistaken reading of *Dodge v. Ford* and the "direct fiduciary" Delaware decisions, multiple other landmark cases and leading authorities, from Delaware itself, support the same proposition as this Article: the corporation

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alleged harm" and "who would receive the benefit of any . . . remedy"); Rales v. Blasband, 634 A.2d 927, 933–34 (Del. 1993) (determining whether to allow a derivative action to proceed, where the board that would consider the pre-suit demand is not the same board that committed the alleged harm); Spiegel v. Buntrock, 571 A.2d 767, 775–76 (Del. 1990) (holding that by sending a demand letter, the plaintiff concedes that the board's decision not to pursue the action should be reviewed under the business judgment rule, thereby practically negating the plaintiff's derivative claims; thus, establishing a universal non-demand rule, where the adjudication on the merits of a derivative action is centered on the issue of demand excusal in the pretrial, motion to dismiss stage); Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (establishing the test to determine whether a demand on the board is excused prior to filing a derivative action). *See also infra* note 244. In Israel, every derivative action involves a preliminary certification stage, consisting of a trial in itself, whereby the court determines if the plaintiff may represent the corporation and proceed to litigate the main case. In that preliminary stage, the court is instructed to consider, first, whether conducting the lawsuit would be in the benefit of the corporation (taken to require a *prima facie* showing of a cause of action) and, second, whether the plaintiff acts in good faith. *See* Israel Companies Act § 198(a). Similarly to Delaware, the actual adjudication on the merits usually occurs in the preliminary stage. The main idea is that derivative actions are different, and usually more complicated to bring and maintain, than direct actions.

160 *See, e.g.*, Israel Companies Act § 204 (allowing creditors of a company to file a derivative action if it arises from certain causes of action, mainly unlawful distribution to shareholders); N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007) ("[I]ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation . . . ." (emphases omitted)).

161 930 A.2d 92.

is the beneficiary of directors' duties, while shareholders have a claim *toward the corporation*, *derived* from its well-being—in any case, a claim different than that which the corporation holds toward *its* fiduciaries.[162]

Eighth, to be certain, shareholders also do not normally owe fiduciary duties to one another. This is especially true with "regular," non-controlling shareholders, not otherwise acting in fiduciary capacity (for example, the tens of thousands known shareholders in *Co-Op*).[163] That is so for a good reason: contrary to a fiduciary position, share ownership carries far more rights than duties. This conforms with the generally held perception of shares, arising mainly from the fact that shareholders pay for their shares and correctly expect to become "creditors" or claimants, not the opposite (debtors or obligors). Even those shareholders who *are* fiduciaries owe their duties *to the corporation*.[164] What *all* share-

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162 *See, e.g.*, *Gheewalla*, 930 A.2d at 101 ("It is well settled that directors owe fiduciary duties *to the corporation*. When a corporation is *solvent*, those duties may be enforced by its shareholders, who have standing to bring *derivative* actions on behalf of the corporation because they are *the ultimate beneficiaries of the corporation's* growth and increased value." (first and last emphases added) (citation omitted)); *Tooley*, 845 A.2d at 1033, 1035 (distinguishing shareholders from the corporation, in the context of discerning direct claims from derivative claims); Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("[Directors'] broad mandate includes a conferred authority to set a corporate course of action . . . designed to enhance corporate profitability. . . . [D]irectors, generally, are obliged to charter a course for a corporation which is in its best interest[.] . . . [A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short term . . . ." (citation omitted)); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629, 636 (2010) ("[T]he director's job demands affirmative action—to protect and to better the position *of the corporation*. . . . [E]very act must be taken for a proper *corporate* purpose[.] . . . [A] loyal fiduciary must protect *the corporation* . . . ." (emphases added) (citation omitted)).

163 *See, e.g.*, Israel Companies Act § 192(a) (stating that all shareholders must act "in good faith", which is merely a recitation of the general normative standard applied to *every* act in private law, by any person, at any time—that is, a non-equitable, non-fiduciary standard, not specific to shareholders. This standard originates from Israel Contracts Act §§ 12, 39, 61(b)); *infra* note 165.

164 *See, e.g.*, Israel Companies Act § 193 (specifying three types of shareholders, mainly a "controlling shareholder" and a shareholder having decisive power in a shareholder meeting, who owe a duty of fairness to the company); Pepper v. Litton, 308 U.S. 295, 306 (1939) ("A director is a fiduciary. . . . So is a dominant or controlling stockholder or group of stockholders. . . . Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested there-

holders do owe to one another is some set of equitable duties.[165] Consistent with a recurring theme of this Article, those duties are equitable, but not fiduciary; they are part of share law, not fiduciary law. The important difference between the fiduciary-beneficiary and shareholder-shareholder relationships has also been pointed out in scholarship.[166]

Ninth, while there are certain situations where directors can be said to have a direct duty toward shareholders, they are the exception, not the rule. These situations, in the U.S. generally known as "*Revlon* mode," arise mainly in the mergers and acquisitions context, when a corporation is nearing the end of life in its current form—a "breakup" or a "sale of control", in the language of the *Paramount* decisions.[167] This is an equitable construct, acknowledg-

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in." (citations omitted). Regarding the quote's final words, *see supra* pp. 293–95 (explaining that where "duties to the corporation and its shareholders," or similar language, is employed, its correct construction is according to the monistic view)); Cinerama, Inc. v. Technicolor, Inc., 1991 Del. Ch. LEXIS 105, at *63 (Del. Ch. June 21, 1991) ("[W]hen a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of the corporation.").

165 *See, e.g.*, Israel Companies Act § 192(b) ("A shareholder shall not act with unfair prejudice toward other shareholders."). In Israel, this is the only statutory duty that applies to *all* shareholders (besides the non-shareholder-specific good faith duty, *see supra* note 163). The law of unfair prejudice is not part of fiduciary law. *See, e.g.*, LICHT, *supra* note 9, at 211 ("[T]he law of unfair prejudice is not based on fiduciary relations supported by duties of loyalty.").

166 *See, e.g.*, Tan Cheng-Han & Wee Meng-Seng, *Equity, Shareholders and Company Law*, *in* EQUITY, TRUSTS AND COMMERCE 1, 9–10 (Paul S Davies & James Penner eds., 2017) ("[I]f the stated basis is that shareholder power must be exercised not for the benefit of the shareholder but for others, this is not the correct principle that operates in a shareholder dispute . . . . This is because there is a fundamental difference in the relationship between partners inter se and between partners and the partnership (which is fiduciary), and between shareholders inter se or between shareholders and the company (which is not). Accordingly, . . . the test of a power that must be exercised for the benefit of another is not an appropriate test where shareholders are concerned.").

167 *See Paramount v. Time*, 571 A.2d at 1150 ("[A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short term[.] . . . [T]here are, generally speaking . . . , two circumstances which may implicate *Revlon* duties. The first . . . is when a corporation initiates [a transaction] involving a clear break-up of the company. . . . [The second is when] a target abandons its long-term strategy and seeks an alternative transaction also involving the breakup of the company. . . . If, however, the board's reaction . . . is . . . not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered . . . ." (citations omitted)); Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 47–48 (Del. 1994) ("There are few events that have a more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise from

ing that when directors make decisions affecting shareholders' own legal and financial positions, in a manner not channeled through the corporation, the person standing to gain or lose from directors' actions is not the corporation, but shareholders. This "channeling principle" might apply in situations outside strict *Revlon* mode;[168] at any rate, these are exceptions. We then extend the usual scope of director obligations, importing fiduciary duties[169] into the *ad hoc* director-shareholder relationship. As if to emphasize that this is the exception, some of the important authorities discussing the rule—duties toward the corporation—do so in the mergers and acquisitions context.[170] Outside such situations,

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a practical standpoint. It is the significance of each of these events that justifies . . . focusing on the directors' obligation to seek the best value reasonably available to the stockholders . . . ." (emphasis omitted)).

168 Such situations include those where the corporation's interests have become extremely minimized, as in *Revlon* itself, or where the corporation's interests are simply not being affected. Consider, for example, an interference with shareholders' voting rights, *see* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (requiring "compelling justification" for "board acts done for the primary purpose of impeding the exercise of stockholder voting power", while discussing fiduciary duties owed by directors to shareholders). In these unique situations, the effect on shareholders is unrelated to what the corporation does, or what happens to it. The corporation does not vote in its shareholder meeting; shareholders do. The remedy goes to the shareholders, not the corporation. Generally, fiduciaries might commit actions that affect shareholders' standing *in relation* to the corporation—in other words, the very content of their rights under share law. Shareholders should be appropriately protected even where fiduciaries' usual duties, to the corporation, are not at issue.

169 *But see supra* notes 154–158 and accompanying text (explaining that because *Unocal* and *Revlon* give rise to an "intermediate standard", lower than entire fairness, it is not the uniformly high standard imposed by the duty of loyalty).

170 *See, e.g.*, *Paramount v. Time*, 571 A.2d at 1150 ("Delaware law imposes on a board of directors the duty to manage the business and affairs *of the corporation*. . . . This broad mandate includes a conferred authority to set a *corporate* course of action . . . designed to enhance *corporate* profitability. . . . [D]irectors, generally, are obliged to charter a course *for a corporation* which is in *its* best interest . . . ." (emphases added) (citation omitted)); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[Once the company was for sale,] [t]he duty of the board had thus *changed* from the preservation of Revlon *as a corporate entity* to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role [before the change was] defenders of the *corporate* bastion . . . ." (emphases added)); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–58 (Del. 1985) ("[T]he board's power to act derives from its fundamental duty and obligation to protect *the corporate enterprise*, which *includes* stockholders[.] . . . [T]he board had a supervening duty to protect *the corporate enterprise*, which *includes* the other shareholders, from threatened harm." (emphases added)); City Capital Assocs. Ltd. P'ship v. Interco, Inc., 551 A.2d 787, 802 (Del. Ch. 1988) ("[T]he duties the board *always* bears [are]: to act . . . in the good faith pursuit of *corporate* interests and *only* for that purpose." (emphases added)).

particularly during the "going concern" phase of corporate existence, directors owe their duties to the corporation,[171] and shareholders' rights come to them from the corporation. In any event, figuring out what directors owe shareholders (in monetary or other terms) necessitates an inquiry of share law. It requires answers to questions such as "why do shares have value?" and "which rules and principles apply in this share-related situation?", all relying on a satisfactory theory and law of shares.

Under the fiduciary approach, the holding in *Co-Op* is not only unjustifiable, it is impossible. That is because in *Co-Op*, there was no breach of fiduciary duty by anyone. The liquidator performed his job diligently, trying to locate as many shareholders as possible. Other fiduciaries, such as the corporation's administrative personnel through the years, also cannot be held responsible: the failure to keep an updated shareholder register is *the corporation's* own act, not any fiduciary's. As a rule, corporations bear their own rights and duties; it is the corporation who had a duty to correctly maintain this register.[172] There is also no reason to assume this was some fiduciary's personally interested act, since none would have gained any benefit from one group of shareholders, rather than another, receiving the funds. Even if the corporation's fiduciaries somehow did wrong, the third point of discussion in this section applies:[173] these people would likely not have US$15 million, or anything close to that, just lying around; nor are most of them alive today; nor would damages of such scope be an appropriate sanction for a relatively small omission (at the time it was made); nor could the fiduciaries (or their heirs) be required to pay such amounts to the unknown shareholders, when the obvious solution, which fits the parties' pre-liquidation expectations, is the one reached by the Court: just keeping the corporation's money undistributed, allowing the unknown shareholders to claim it when they do. All along, the shareholders' claim was toward funds in the corporation's, not any fiduciary's, pocket. Clearly, *Co-Op* is a cor-

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171 *See, e.g.*, ROTMAN, *supra* note 66, at 512 ("By analogy with the application of *Revlon* duties, it would seem logical that so long as the corporation remains viable as a going concern, directors and officers retain fiduciary duties to act in the corporation's best interests.").

172 *See* Israel Companies Act § 127 ("A company shall administer a shareholder register."), § 130(a) ("In the shareholder register [the following] shall be registered[:] . . . The name, identification number and address of each shareholder, all as submitted to the company[.] . . .").

173 *See supra* p. 292.

porate law case, but not a fiduciary law case. It is a case in share law.

5.5. *Summary of the Four Approaches*

As we now see, in reality, none of the approaches surveyed above is the law. Indeed, like many[174] other creditors, shareholders are parties to a contract with the corporation. It is perfectly correct to say that shareholders are "creditors"—as long as we keep in mind that they are a *singularly unique* type of creditors. Their contract is inherently coupled with extra-contractual, equitable norms. Without this qualification, and the special treatment stemming from it, the shareholders' contract would be practically meaningless, and certainly not align with the parties' actual expectations and the generally accepted perception of shares.

It is also true that shareholders have some sort of claim related to the corporation's net worth, but that claim is not a property right, nor is it identical to a trust beneficiary's claim toward a trustee or trust property.

Finally, it is correct that shareholders have rights different than those of all other creditors, but they do not have direct claims toward directors or other fiduciaries. Rather, the corporation itself, who is the beneficiary of its fiduciaries' duties, is the vessel through which shareholders' rights flow.

In summary, the rights, or even the *existence*, of shares and shareholders cannot be adequately explained by contract, property, trust or fiduciary law. This should hardly serve to weaken or obscure them: "Doctrinal formalism has been no match for human nature's inclination towards fairness and justice."[175] So, where do they come from?

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[174] Many, but not all, creditors have a contract with the corporation. For example, tort law injured parties are involuntary creditors, having no such contract. They may be grouped together with non-residual contract creditors in that the rights of both arise primarily in law, not equity.

[175] LARRY A. DIMATTEO, EQUITABLE LAW OF CONTRACTS 150 (2001).

6. EQUITY AS THE FOUNDATION OF SHARE LAW

Equity is the field of jurisprudence meant to promote justice and fairness in situations where regular "law" is unfit or insufficient for that purpose.[176] As this Article demonstrates, that is precisely what happens with shares: first, shares have characteristics, such as textual (contractual and legal) ambiguity and the phenomenon of residuality, which make them impossible to comprehend in familiar legal terms. Second, all the seemingly applicable areas of law (contract, property, trust and fiduciary law) are maladjusted to treat shares. Trust and fiduciary law are branches of equity. Yet, equity is a field in its own. Other branches of it may also exist. As it turns out, an important branch of equity is share law.

There are many angles from which to explore the link between shares and equity. This Part of the Article turns to the following: residuality, the equity contract, and historical and linguistic connections.

[176] This idea is inherent to equity, both conceptually and historically. *See, e.g.*, Anton-Hermann Chroust, *Aristotle's Conception of Equity (Epieikeia)*, 18 NOTRE DAME L. REV. 119 (1942) (explaining Aristotle's view of equity as a supplement to law, whenever the latter has to be rectified for achieving justice); F. W. MAITLAND, EQUITY, ALSO THE FORMS OF ACTION AT COMMON LAW 3–6 (1909) (describing the rise of equity as a response to inadequacies in the administration of law, especially what we today call power and information asymmetries: "Though these great courts of law have been established there is still a reserve of justice in the king. Those who can not [sic] get relief elsewhere present their petitions to the king and his council praying for some remedy. . . . Very often the petitioner . . . complains that for some reason or another he can not [sic] get a remedy in the ordinary course of justice and yet he is entitled to a remedy. He is poor . . . , his adversary is rich and powerful . . . , or has by some trick or some accident acquired an advantage of which the ordinary courts with their formal procedure will not deprive him. . . . The complaints that come before [the Chancellors] are in general complaints . . . which [the ordinary courts] ought to redress. But then owing to one thing and another such wrongs are not always redressed by courts of law."). The analogy, between Maitland's plaintiff and the modern shareholder (if not for the protections of equity), is apparent. For some of Maitland's insights on the development of corporate law and shares, *see* F. W. Maitland, *Trust and Corporation*, *in* STATE, TRUST AND CORPORATION 75 (David Runciman & Magnus Ryan eds., 2003) [hereinafter: Maitland, *Trust and Corporation*] (chronicling the origins of trusts and the rise of corporations). *See also* Joshua Getzler, *Frederic William Maitland - Trust and Corporation*, 35 U. QUEENSLAND L. J. 171 (2016) (exploring the background and key thesis of Maitland's work).

6.1. Equity and Residuality: Two Links

The concepts of "equity" and "residuality" are related in two ways. First, equity is a normative framework needed in a situation where a claimant's rights are residual, *wholly* dependent on another person. That is because, similarly to other equitable relationships, the claimant is severely disadvantaged in power and information, compared to his obligor (in this case, mainly the corporation). The second link between "equity" and "residuality" lies in the fact that equity is a residual normative framework—simply, it is the one left over after all others fail to accommodate a given situation.

First, a shareholder, while not a trust[177] or fiduciary law beneficiary,[178] is situated in a *very similar* position to these types of actors. Members of all three groups may be termed "equity claimants." That is because, like the other two, a shareholder is not a regular contractual party. A shareholder is *inherently disadvantaged* vis-à-vis his obligor—in this case, mainly the corporation.[179] This inferiority is in terms of both power (the ability to affect one's legal position) and information (the ability to know what that position is). This results from the unique phenomena explicated above:[180] first, the share contract (constitutional documents) is exceptionally undetailed, compared to other contracts regularly entered into in private law. Second, the shareholder's claim relates to the ever-fluctuating residual, or difference between the corporation's assets and liabilities, so it is not grounded in any fact of external reality; the shareholder's claim is *entirely* dependent on the corporation. As with any person, the corporation's fate can result from its own deeds, or from acts done to it by others. In any case, shareholders can hardly do anything to control these actions. They have some governance power, but it is practically limited to appointing *other* people and hoping they, and the corporation, do the right thing. Shareholders must accept what the corporation hands them, good or bad, with little recourse to any *legal* claim. Yet, that is not what

177 *See supra* Part 5.3.

178 *See supra* Part 5.4.

179 In addition to the other relationships that arise from shares: the shareholder-shareholder and shareholder-third party relationships. *See supra* pp. 277–78. In each of these, as well, a shareholder might stand in a position of power or information asymmetry to one or more of the other parties.

180 *See supra* Part 3.

the parties opt for: the corporation ought to try and succeed, with an understanding that this will *also* protect and grow shareholders' investment. Shareholders give their money to the corporation, who now owns it; yet, there is a sense that shareholders continue to own an interest in it, somehow different than that of a "regular" creditor. A mismatch exists between the parties' rights and the legal tools available to address them. Therefore, justice and simple reason require that the share relationship not be seen as a regular, arm's length relationship under "law" only, but rather, as one that invokes the protections of equity.

The substantive content of shareholders' equitable claim is similar, albeit different, than that of other equity claimants. For instance, under trust, fiduciary, and share law, the claimant enjoys a quasi-proprietary right toward property owned, held, or managed by another person. This is not a full proprietary right under property law; it is also not a mere obligatory right under contract law. It is something in-between, and the questions pertaining to it are answered in the field of equity.

The major difference between the various equity claims is that trust and fiduciary law impose the duty of loyalty, but share law does not. That duty requires total self-abnegation by the trustee or other fiduciary,[181] while a corporation can, and in many respects *must*, operate for its own benefit.[182] Another illustration of non-fiduciary equity lies in the operation of courts: standards of review for actions affecting shareholders *per se* and the corporation are different.[183]

Shareholders' lack of fiduciary claims can become very consequential: take, for example, a shareholder facing bankruptcy, which would be avoided only if the shareholder received a dividend from the corporation. If the corporation, or even its directors, were fiduciaries for the shareholder, they would have to pay the dividend, consistent with fiduciary principles of self-abnegation and acting only in the beneficiary's interest.[184] However, such duty

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[181] *See supra* notes 68, 69.

[182] *See supra* notes 142, 145.

[183] *See supra* notes 154–158 and accompanying text (explaining that although direct duties toward shareholders are often referred to as "fiduciary" duties, they may give rise to less stringent, "intermediate" standards, inconsistent with fiduciary law principles).

[184] One might respond that the "fiduciary" (whether the corporation or its directors) presumably owes duties not to any specific shareholder, but to shareholders "collectively" or to a "fictional shareholder." *See, e.g.*, Davies, *supra* note 152; Caleb N. Griffin, *The Hidden Cost of M&A*, 2018 COLUM. BUS. L. REV. 70, 80 n.24

clearly does not exist in positive law, or normatively: the corporation is meant to pursue its own benefit and its own plans (which a large dividend might upset); corporate decisions, including those on dividends, must accord with *the corporation's* interests.

Of course, that the corporation is not shareholders' fiduciary does not mean it can do whatever it wishes, even if that harms shareholders, or otherwise violates the terms of the relationship. The strong link, between the corporation's well-being and that of its shareholders,[185] is guarded by equity. The translation of the former into the latter is achieved through the workings of share law, many of which are discussed in Part 7 of this Article.

Second, equity may be viewed as a *residual normative framework*, designed to provide conceptual and doctrinal infrastructure for dealing with situations where other fields of jurisprudence are insufficient, irrelevant, or would lead to incorrect results. As this Article demonstrates, the origin and nature of shares, and the rights of shareholders, cannot be explained through "law"—contract and property law.[186] Even two *branches* of equity—trust and fiduciary law—have specific characteristics that similarly preclude them from serving that purpose: trust law is built on narrow definitions and does not correspond to the nature of the modern corporation;[187] corporate fiduciary law is indeed an important *part* of corporate law, but it pertains to a separate relationship, that involving directors and other fiduciaries, to which the corporation is party, but shareholders are not.[188] The corporation itself also is not

(2018) (citing sources that discuss the "fictional shareholder"). However, such a statement is meaningless in terms of fiduciary law, which deals with very strict obligations to actual persons. Practically, duties to a "fictional shareholder" are indistinguishable from duties to the corporation (an actual, identifiable person). There is no reason, then, to misapply the unique norms of fiduciary law, by misidentifying the parties to the various relationships. "Fictional shareholders," "shareholders as a whole" and similar phrases simply place us back in the framework of share law, as discussed in this Article.

185 Most of the time, that link appears obvious: a gain for the corporation is an indirect gain for shareholders. Practically, they may realize it through such events as the distribution of a dividend, or selling their shares in the secondary market. In any case, these are channeled through share law: shareholders cannot reach any of the corporation's assets or interests, except through their shares and the legal framework governing them. Furthermore, it is possible for the corporation's interests to diverge from those of its shareholders. *See supra* notes 86, 145.

186 *See supra* Parts 5.1, 5.2.

187 *See supra* Part 5.3.

188 *See supra* Part 5.4.

shareholders' fiduciary.[189] Shareholders have claims similar to those found in fiduciary law (in that both are more-than-contractual, non-arm's length), but uniquely, no one owes them a duty of loyalty. Yet, they invest fortunes, in money or effort, to acquire their shares.[190] Due to this and related reasons (such as defending legitimate expectations and encouraging further investment), they undoubtedly have rights, deserving of protection. We face a situation where four different, well-developed areas of law cannot serve as the foundation of those rights. What is left is equity itself, or more specifically, equity-based share law.

The *Co-Op* decision illustrates both of these links between equity and residuality. First, the Court treats shareholders' claim toward the rights arising from their shares as having some quasi-proprietary traits. This is exemplified by the Court not mentioning any statute of limitations or similar issue, which is consistent with the rights of an equity claimant, rather than a purely contractual party.[191] Of course, this is also demonstrated by the final result in the case: the Court treats the unknown shareholders' rights as quasi-proprietary, first, when it defends their claims' continued existence (rather than distributing the money to the known shareholders), and second, when it orders the creation of a trust for an unlimited period, where the unknown shareholders' funds will be held. Since proprietary rights, unlike obligatory (contractual) ones, are generally unlimited in time (they do not have a "maturity date"), this conforms with a quasi-property, or equity, approach.

From another typical perspective, the Court recognizes that the unknown shareholders are a weak, disadvantaged party. Despite possessing a considerable financial claim, they do not even know about it. The unknown shareholders are completely unable to defend their interests. The power and information asymmetries here are apparent. They are even more extensive than in most equity cases. These shareholders truly need the protection of equity, and the Court does not turn its back on them: it acts as a court of equity.[192]

Second, *Co-Op* also exemplifies how equity serves as a residual

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[189] *See supra* Part 5.3, specifically *supra* note 132.

[190] *See supra* notes 2, 103.

[191] *See supra* note 111 and accompanying text.

[192] *Cf.* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("[T]he court of equity is at all times open to complaining shareholders having a just grievance.").

normative framework. That is because the Court's decision simply cannot be explained any other way. As the opinion shows,[193] the Court never finds it necessary to delve into substantive contractual, property, trust, or fiduciary law analysis. Even if it tried, Part 5 above illustrates how these approaches are simply incorrect, or (especially the fiduciary approach) completely irrelevant to the facts of the case. Furthermore, despite the Court browsing through many of those, no statutory—that is, "law"—provisions actually establish the outcome. Effectively, the Court takes the equity approach for granted. The treatment of shareholders as equity claimants operates behind the scenes of the decision: what the Court is essentially doing, throughout the lengthy opinion, is trying to find some legal exception to the equitable rule of shareholders' more-than-contractual, quasi-property rights. When the Court finds no such exception, it does what it perceives as obvious, and orders the conservation of the funds for the unknown shareholders' benefit.

6.2. Shares as Equitable Rights of Contractual Origin

Another way to explain the link between shares and equity, briefly discussed above,[194] employs a fairly straightforward idea: shareholders have equitable rights, bundled into shares, because the corporation and its shareholders have entered into a contract that calls for such rights. In other words, corporate constitutional documents are a contract that *also* gives rise to an equitable relationship. This statement is nothing far-reaching: a trust contract[195] with a trustee[196] operates the same way.[197] The contract-equity duality naturally extends into corporate law, as the Delaware Court of

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[193] *See supra* pp. 266–69.

[194] *See supra* pp. 284–85.

[195] Also often called a "deed of trust" or "trust instrument."

[196] *See, e.g.*, Israel Trust Act § 2 ("A trust is created according to law [or] according to a contract with a trustee . . . .").

[197] The argument here is not that an equitable relationship is purely or mainly contractual (and can be contracted around), as has been claimed in regard to fiduciary relationships, *see, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. L. & ECON. 425 (1993). Rather, the argument is that more-than-contractual obligations can be imposed with the aid of a contract. People can agree to be bound by certain *legal norms*, including the norms of equity. In other words, the parties can create a stone that the contract cannot lift. More accurately, they invoke a pre-existing stone: equity.

Chancery had vigorously emphasized.[198]

In effect, the parties voluntarily summon the norms of equity to be part of their relationship. They do so not in explicit writing—it would be unusual to find constitutional documents that state "the norms of equity are part of this document for all intents and purposes"—but, in accordance with contract law rules of construction, through intent and implied covenants. The parties, necessarily unaware of the extremely wide range of eventualities that might occur (as *Co-Op* vividly illustrates), absorb equity into their agreement, because that is the only way to deal with this lack of ability to look into the future.[199]

The injection of equitable norms into the shareholders' contract, and not into others (such as bonds), is justified because a residual claim contract simply *cannot ever* be detailed enough to protect shareholders from the possibilities that uniquely attach to their claim.[200] Even if it could, constitutional documents are just not very detailed in practice, due to the parties' natural efficiency motives, pushing them to comply with legal dictates and not much more.[201] Unlike shareholders, bondholders have a claim to a certain (or contractually determinable) amount of money, at a certain (or contractually determinable) date. That claim is grounded in facts of reality—concepts of money and time—that lie outside the corporation.[202] If a bond contract is breached, bondholders will promptly know that and will likely seek remedy, emanating either from the bond itself or from external legal default rules.[203] Similar-

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198 *See, e.g.*, Sample v. Morgan, 914 A.2d 647, 664 (Del. Ch. 2007) ("An essential aspect of our form of corporate law is the balance between law (in the form of statute and contract, including the contracts governing the internal affairs of corporations, such as charters and bylaws) and equity . . . . Stockholders can entrust directors with broad legal authority precisely because they know that that authority must be exercised consistently with equitable principles . . . ." (citing Berle, *supra* note 126; Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971))).

199 *See, e.g.*, Tan & Wee, *supra* note 166, at 12 ("The common thread . . . is that reasonable shareholders would not generally contemplate the occurrence of such circumstances within companies of which they are members (even though there was no express discussion or agreement between them on such matters) and equity will therefore not allow the exercise of strict legal rights to maintain this uncontemplated status quo.").

200 *See supra* Part 3.

201 *See supra* notes 5, 6.

202 On the distinction between residual claims and those grounded in external reality, *see supra* p. 276.

203 *See, e.g.*, LICHT, *supra* note 9, at 232 ("In the [arm's length] relationship [between debtor and creditor], the person who suffers a breach is basically aware of his interests, and when a breach occurs he knows about it—that his property or

ly extensive laws also protect other creditors, such as employees. In the share context, however, neither the contract itself nor legal default rules are designed to answer all questions that can possibly arise, or even those that frequently do arise. Shareholders *must* have equity in their contracts because otherwise asserting a "breach" would almost never succeed. On purely legal-contractual grounds, it is impossible to prove that a dividend "should" be distributed,[204] or that shares have been allocated to new owners for "too low" a price,[205] or that shareholders, as in *Co-Op*, have "quasi-property" rights, unlimited in time. Equity is well-versed in precisely these kinds of inconvenient arguments.

As this Article shows, the majority of share-related concepts and norms are simply not written anywhere; they seem to be taken "for granted." It is as if the parties are somehow told: "you do not have to think of this in advance; when questions arise, people just know what to do." Of course, people would *not* know what to do, if not for equity, designed to provide answers that cannot be found elsewhere. As a result, like every director employment contract[206] implicitly absorbs the norms of corporate fiduciary law, every corporation's constitutional documents implicitly absorb the norms of equity-based share law.[207]

The outcome reached by the Court in *Co-Op* precisely squares with the above. Every time a Co-Op shareholder assumed this position, the corporation and the shareholder agreed to a contract. That contract is the corporation's constitutional documents, and these contain equitable norms. It is implicitly perceived by the parties that shareholders have an equitable claim, which, as *Co-Op* demonstrates, makes it a quasi-property claim. Accordingly, it is unlimited in time, and is "stronger" than a mere contractual claim in other respects as well.[208] Indeed, discussing "quasi"-property rights, which straddle the line between several legal disciplines, is

body were damaged or that his contract was not fulfilled.").

204 *See supra* note 83.

205 *See supra* note 84.

206 That is the contractual arrangement, unwritten in part, that governs the relationship between a director and the corporation. *See supra* note 72; *supra* pp. 292–93.

207 *Cf.* Tan & Wee, *supra* note 166, at 15 ("Although a contractual approach has judicial support, it operates only by analogy and it must not be forgotten that the basis of the court's jurisdiction lies in equity. Any contractual analysis must ultimately be able to support relief in equity.").

208 *See supra* p. 283.

not easy. Yet, aside from being time-honored,[209] this usage is unavoidable, due to the complexity of human affairs. Situations and relationships, commercial or otherwise, are not made to fit into pre-existing molds.[210]

6.3. Other Perspectives on the Share-Equity Link: History and Language

The close relation between the concepts of shares and equity can also be examined from two more perspectives: historical and linguistic. Historically, modern corporations developed as creatures of equity. By the 17th century, "joint stock companies" began to surface in England.[211] In practice, they were very similar to partnerships.[212] The analogy is that in a partnership, partners have the power to influence the legal position of each other, in various ways not pre-defined in contract or otherwise, thereby necessitating the protections of equity; in a company, that power is vested mainly with the company itself, and acts toward its shareholders. However, partnership law only partly and ineffectively responded to the needs of rapidly growing corporations during the 18th and 19th centuries.[213] As a result, "real" company law developed, retaining equity as its foundational concept.[214] Corporate law changed considerably over the years, but equity remains at its core.[215] As this Article illustrates, the range of situations that shareholders can find themselves in is remarkably wide. Equity responds to this fact as it guides the daily practice and adjudication of corporate law.

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[209] *Cf.* Maitland, *Trust and Corporation*, *supra* note 176, at 109 ("*quasi* is one of the few Latin words that English lawyers really love . . . .").

[210] *Cf.* LEVENSTEIN, *supra* note 58, at 61 ("All law, no matter its content or era, is flawed . . . . Equity could not plausibly surmount this very *human* limitation, but its charge is nevertheless to attempt the impossible.").

[211] *See, e.g.*, Tan & Wee, *supra* note 166, at 1.

[212] *See id.*

[213] *See id.* at 2.

[214] *See id.* at 4 ("[A]s the business organisation that was adopted in early company law was based on a fusion of partnership and trust law, together with the law of agency, which were all heavily infused by equitable doctrines, company law was susceptible to the influence of the law of equity." (citation omitted)).

[215] *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919); Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007) (two judicial decisions, reached 88 years apart, both pointing to equity as a fundamental norm of corporate law).

The linguistic connection between "shares" and "equity" is practically taken for granted. This link does not necessarily prove that the two *should* be related—other sections of this Article deal with that. Rather, it is one proof that they *are* related, on a very intuitive, culture-wide level. This connection can be seen in the interchangeable use of the phrases "share," "stock," and "equity." For example, the word "equity" might simply be used instead of "shares."[216] A textbook might introduce the various types of financial instruments that a corporation can issue, grouping shares under the title "Equity Securities".[217] The phrase "shareholders' equity" is equivalent to "the corporation's net worth," or assets minus liabilities (obligations to non-residual creditors). "Shareholders' equity" is very widely used and appears regularly in, among other places, corporations' financial reports[218] and the press.[219] At a web forum devoted to English linguistics, an explanation, generally similar to that presented in this Article, was offered in regard to the link between the two concepts.[220]

7. TOPICS IN SHARE LAW

What else is part of share law? The previous Parts of this Article mainly discuss the equitable principles of share law. Yet, these are only a fraction of that field. This Part offers a non-conclusive list of topics in share law, frequently encountered by businesses,

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216 *See, e.g.*, ALLEN & KRAAKMAN, *supra* note 63, at 145 (using the title "Legal Character of Equity" for a section on the characteristics of shares).

217 *See* ALAN S. GUTTERMAN, THE LEGAL CONSIDERATIONS IN BUSINESS FINANCING: A GUIDE FOR CORPORATE MANAGEMENT 20 (1994) (describing the basic types of equity securities).

218 *See, e.g.*, Berkshire Hathaway Inc., *Form 10-K*, SEC.GOV (Feb. 26, 2018), https://www.sec.gov/Archives/edgar/data/1067983/000119312518057033/d437858d10k.htm [https://perma.cc/KU4G-H848] (annual report mentioning the phrase "shareholders' equity" 28 times).

219 *See, e.g.*, Sui-Lee Wee, *After Wanda Deal, Chinese Property Developer Faces Debt Risk*, N.Y. TIMES (July 14, 2017), https://www.nytimes.com/2017/07/14/business/dealbook/china-debt-wanda-sunac.html [https://perma.cc/TCL3-Q9HH] ("In 2016, the company's net gearing ratio—a measure of total debt to shareholders' equity—rose to 121.5 percent . . . .").

220 *See* Kevin Beach, *Reply in thread titled "Equity - companies and corporations"*, WORDREFERENCE.COM (Dec. 14, 2010), https://forum.wordreference.com/threads/equity-companies-and-corporations.2007192/#post-10036633 [https://perma.cc/TER8-5C93].

lawyers, judges, legislators, and scholars. This list is meant to serve as a guide for further inquiry, tying these topics together under the share law classification.

1. *Statutory share law*. As mentioned above,[221] corporate statutes, such as the Delaware General Corporation Law and the Israel Companies Act, contain multiple sections dealing with shares. These statutory provisions, and the myriad issues they cover, are part of share law. Some of these issues are also discussed below.
2. *Share allocation and dilution*. Shares are a sensitive and manipulable way to represent claims toward a common pool of wealth. For example, when new shares are allocated for less than the economic value of each current share, wealth indirectly flows from current to new shareholders. This is a core issue of share law, also addressed in litigation and scholarship.[222]
3. *Dividends and buybacks*. A transfer of economic value from a corporation to its shareholders, by virtue of them being shareholders, is known as a distribution. These actions include dividends and buybacks.[223] This is a hotbed of legal issues, some among shareholders themselves (for example, if the distribution is not made equally), some between shareholders and the corporation,[224] and some between the corporation and its creditors.[225]
4. *Various aspects of mergers and acquisitions*. These are, after all, transactions in shares. M&A law might sometimes seem to focus on issues of corporate fiduciary law, such as directors' duties on either side of the *Revlon* threshold;

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221 *See supra* note 6.

222 *See, e.g.*, *supra* note 84; Mira Ganor, *The Power to Issue Stock*, 46 WAKE FOREST L. REV. 701 (2011).

223 *See, e.g.*, Israel Companies Act § 1 (defining "Dividend" and "Distribution").

224 *See, e.g.*, *supra* note 83 and accompanying text. The opposite situation is also possible: if an unlawful distribution occurs, *see infra* note 225, the corporation might gain a right of rescission toward the shareholder. *See* Israel Companies Act § 310. This right may also be enforced derivatively by creditors, *see supra* note 160.

225 *See, e.g.*, DGCL §§ 160(a), 170–174 (establishing mandatory rules to determine when a corporation is allowed to make a distribution to its shareholders, requiring that distributions not "impair" the corporation's capital, or that they be made out of the corporation's profits); Israel Companies Act §§ 301–305, 307, 309–313 (establishing mandatory rules to determine when a company is allowed to make a distribution to its shareholders, requiring, without exception, that it maintain its ability to meet all obligations to creditors).

however, for such issues to arise, there has to be some (actual or planned) deal—a share transaction, which must also conform with share law. For instance, when can shares be taken away, or even cancelled, without their owner's consent? When is it permissible to diverge from the rule of equality among identical shares?[226]

5. *Appraisal rights*. Appraisal is rooted in equitable considerations; the power and information asymmetries inherent to shares make a determination of their true value, when they are taken from their owners,[227] involve more than looking at their market price, if they have one at all. This topic lies deep within share law; tellingly, appraisal requires no fiduciary breach.[228]
6. *The distinction between shares and other securities*. This topic is important in the general structure of corporate law,[229] as well as in the preferred share context.[230] It is also critical in accounting: when a corporation gets money for a newly issued security, those funds have to be placed, in the balance sheet, under either "liabilities" or "shareholders' equity."

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226 For example, in *Unocal*, the corporation announced a self-tender offer, aiming for a large buyback of its shares; the offer excluded one shareholder, who was trying to acquire control of the corporation at the time. This unequal treatment, of shareholders having the exact same security, was deemed lawful. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54, 955 (Del. 1985) (finding that "in the acquisition of its shares a Delaware corporation may deal selectively with its stockholders", if the action is not "inequitable"). Federal securities law was later amended to prohibit a discriminatory self-tender offer. *See* 17 C.F.R. § 240.13e-4(f)(8) (2006) ("No issuer or affiliate shall make a tender offer unless: . . . The tender offer is open to all security holders of the class of securities subject to the tender offer[.]"). However, unequal treatment of identical shares is still possible in other M&A-related settings, as with the poison pill, where a rights issue can be made to some shareholders and not others.

227 The question of which shareholders are entitled to appraisal rights is answered quite differently in different jurisdictions. *See, e.g.*, DGCL § 262 (granting appraisal rights to shareholders voting against a cash-out merger); Israel Companies Act § 338 (granting appraisal rights to offerees in a potentially coercive tender offer). Appraisal rights may also arise outside of the M&A context, albeit exceptionally. *See, e.g.*, Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L. J. 223, 251–54 (1962) (discussing appraisal rights following amendment of constitutional documents).

228 *See, e.g.*, Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597, 648 (2017) ("[T]he petitioners in [statutory appraisal] litigation . . . need not plead any breach of fiduciary duty . . . .").

229 *See supra* Part 4.

230 *See supra* pp. 280–81.

Therefore, share law must provide clear rules in this area.

7. *Share-related securities*. Such securities include warrants, convertible bonds, rights issues, restricted share units (RSUs), and other convertibles. As with shares (and in different ways, suited to the characteristics of each security), equity is involved here. These securities also include American Depositary Receipts (ADRs) and similar instruments, giving rise to issues regarding their owners' precise legal standing—in other words, to what extent are they like regular shareholders.
8. *Multiple-class equity, as opposed to "one share, one vote"*. This is a highly salient issue. Even in Israel, where the stock exchange is explicitly prohibited by statute from listing equity securities of companies with more than one class of shares,[231] recent case law has emerged on this topic.[232] All the relationships dealt with in share law are affected by this choice: the shareholder-corporation (as some shareholders are left without any meaningful say on the corporation's affairs), shareholder-shareholder (as shareholders of different classes have diverging interests, and might more readily act adversely to one another), and shareholder-third party relationship (the main third party being the corporation's fiduciaries, who are often personally interested in the existence of multiple share classes).[233]
9. *Secondary market share transactions*. Here, share law interacts with securities law. Such transactions may also lie outside securities law, as in the case of private corporations. Quantitatively, most share transactions are in the secondary market, not involving the issuing corporation. This topic includes various aspects of the routine trading of shares on stock exchanges, in addition to other practices—for example, equity decoupling, where different rights arising from

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231 *See* Securities Act, 5728-1968, § 46b, SH No. 541 p. 234 (Isr.).

232 *See* CC (TA) 40274-09-15 Perrigo Co. plc v. Mylan N.V. (Oct. 28, 2015) (Isr.), https://www.nevo.co.il/psika_html/mechozi/ME-15-09-40274-859.htm [https://perma.cc/J9NR-DMB8] (holding that in certain circumstances, mainly due to policy considerations such as the promotion of securities market activity, shares of a foreign corporation with multiple classes of authorized shares may be registered for trading on an Israeli stock exchange).

233 For recent discourse on this topic, *see, e.g.*, Robert J. Jackson, Jr., *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, SEC.GOV (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty [https://perma.cc/HTQ6-ACW3].

a single share (voting, dividends, etc.) are contractually transferred, by a shareholder, to different owners.[234]

10. *Non-economic changes to shares*. This topic involves actions such as a share split and share consolidation (or "reverse share split"), as well as the allocation of bonus shares. As a rule, these actions represent no transfer of economic value from one person to another. Yet, they exemplify how shares are sensitive to various errors and manipulations. The seemingly benign "non-economic" transaction might actually cause a transfer of wealth. This can happen, for example, when a shareholder owns a number of pre-transaction shares that does not wholly divide by the consolidation ratio. If a corrective measure is not taken (namely, the payment of cash or other compensation for the fractional share), some of the shareholder's claim "disappears," or usually, is transferred to other shareholders. Another aspect of this topic relates to the shareholder-third party relationship.[235] Brokers, banks, online financial information platforms and others may commit errors, often unintentionally, in the context of non-economic share transactions—for example, treating the share price as if it actually changed. Unless these mistakes are recognized and corrected, the loss of legal and economic rights gives rise to a legally enforceable claim.
11. *Shareholder registration*. How does one know who the corporation's shareholders are? Usually, through a dedicated list, administered by the corporation: the shareholder register. This becomes more complex with public corporations, whose shareholders change very rapidly. An important issue in this area is nominee companies, such as Cede & Co., who appear in public corporations' shareholder registers as "street name" holders. In Israel, the real, ultimate shareholders are also the full legal shareholders, for all intents and purposes;[236] it would be advantageous to minimize any

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[234] *See, e.g.*, Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) [hereinafter: Hu & Black, *The New Vote Buying*]; Henry T. C. Hu & Bernard S. Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, *in* INSTITUTIONAL INVESTOR ACTIVISM 349 (William W. Bratton & Joseph A. McCahery eds., 2015) [hereinafter: Hu & Black, *Debt, Equity, and Hybrid Decoupling*].

[235] *See supra* pp. 277–78.

[236] *See* Israel Companies Act § 132 (stating that "a nominee company shall

confusion around this issue in other jurisdictions as well.[237] Also within this topic is the issue of bearer shares.[238]

12. *Shareholder meetings and voting*. While shareholders are normally not fiduciaries for the corporation, their choices might still bind it; however, no individual shareholder can do so.[239] Rather, shareholders must go through the mecha-

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not be considered a shareholder of the [issuing public company], and the shares in its name are owned by those entitled to them . . . .", and that upon a shareholder's request, the shareholder's name shall be registered in the issuing company's shareholder register, in respect to the appropriate number of shares, substituting the nominee company's name). The nominee company is not even a trustee, as it never owns the shares. It is part of a mechanism related only to registration.

[237] Shares are exceedingly sensitive to various misunderstandings to begin with, and the current nominee system in the U.S. makes the situation far worse, bordering on the absurd. *See, e.g.*, Matt Levine, *Banks Forgot Who Was Supposed to Own Dell Shares*, BLOOMBERG (July 14, 2015), https://www.bloomberg.com/view/articles/2015-07-14/banks-forgot-who-was-supposed-to-own-dell-shares [https://perma.cc/92EH-AU6H] (discussing specific cases of nonsensical outcomes under the U.S. nominee system). For an overview, *see* David C. Donald, *The Rise and Effects of the Indirect Holding System: How Corporate America Ceded its Shareholders to Intermediaries* (Sept. 27, 2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1017206 [https://perma.cc/JLT8-WGSP]. Reform is clearly needed in this area, possibly requiring changes to both state corporate law and federal securities law, to produce a rule similar to that in other jurisdictions, *see supra* note 236.

[238] The ownership of a bearer share is not determined using a central register, but through a share warrant, which is usually a transferable paper document, governed by both share law and negotiable instruments law. Expectedly, this creates its own set of issues. It can rather easily give rise to situations similar to those encountered in the *Co-Op* case, *see supra* Part 2. For example, in Switzerland, in 2018, legislation has been proposed to convert all bearer shares, of all private companies, into registered shares, by operation of law. However, the proposal includes the following: "After the expiry of the grace period [for surrendering share warrants to the issuing company], shareholders who have not identified themselves will definitively lose all rights attached to the shares. Their shares will be deemed void and the company will need to issue, in place of such void shares, new shares as treasury shares." Daniel Jenny & Florian Jung, *Farewell to bearer shares and introduction of criminal sanctions for violations of transparency obligations?*, LEXOLOGY (Mar. 7, 2018), https://www.lexology.com/library/detail.aspx?g=f8b31110-c8c2-4099-a0f8-043e05d3d49a [https://perma.cc/YAQ6-5427]. Given the nature of shareholders' rights, as discussed in this Article, it is clear why that proposal is extremely problematic. Furthermore, owners of bearer shares are *especially* prone to being unaware of their shareholding and not contacting the issuing corporation, thereby inadvertently and unjustifiably being placed at risk of their rights "disappearing." There are many alternatives to the excessive proposal quoted above; one would be adopting a similar solution to that reached by the *Co-Op* Court: registering the shares in the names of trustees, or a comparable arrangement, for the benefit of the unknown shareholders.

[239] If a shareholder *does* individually (or in cooperation with others) have the power to bind the corporation, or materially influence its course of action, that

nism of *voting* in *shareholder meetings*. This topic is in very high currency, particularly in the U.S., due to the activist shareholder phenomenon.[240] It interacts with other topics listed here, such as the relation between share law and corporate fiduciary law. This arises both in director elections, and in voting on other proposals, as when shareholders seek to constrain management from pursuing certain activities. This topic also relates to other issues, such as vote buying[241] and circular share ownership.[242]

13. *Other shareholder governance rights*. These mainly include access to information.[243] Such rights are necessary to minimize the information asymmetries that shareholders are inherently subject to. This topic has far-reaching implications for other areas of corporate law, including the conduct of

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shareholder owes fiduciary duties to the corporation. *See supra* note 164. Yet, it is possible for many dispersed shareholders, in their meeting, to lawfully reach a decision—even one that seriously affects the corporation—with no prior agreement or coordination among themselves, and with none of the shareholders owing any fiduciary duty. This is another unique aspect of share law.

[240] *See generally* INSTITUTIONAL INVESTOR ACTIVISM (William W. Bratton & Joseph A. McCahery eds., 2015); LISA M. FAIRFAX, SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION (2011).

[241] *See, e.g.*, Schreiber v. Carney, 447 A.2d 17 (Del. Ch. 1982) (defining vote buying and upholding the legality of such agreements, if they are not fraudulent or disenfranchising); Hu & Black, *The New Vote Buying*, *supra* note 234; Hu & Black, *Debt, Equity, and Hybrid Decoupling*, *supra* note 234.

[242] *See, e.g.*, DGCL § 160(c) (suspending the voting rights arising from shares owned by the issuing corporation itself, or by another corporation, if the majority of the latter's voting shares are owned by the issuing corporation); Speiser v. Baker, 525 A.2d 1001 (Del. Ch. 1987) (broadly construing DGCL § 160(c), by suspending the voting rights attached to shares owned by a corporation *effectively* controlled by the issuing corporation). In Israel, this pertains to the concept of vacant shares, also known as treasury shares or dormant shares. Such shares are created whenever a corporation buys back shares it formerly issued, without immediately cancelling them. *See* Israel Companies Act § 308. Hence, this also relates to the topic of buybacks, *see supra* p. 312. Vacant shares provide neither voting rights nor any other right. *See* Israel Companies Act § 308. The principle operating here is that it is impossible to contract with oneself; every contractual relationship (in this case, that arising from the constitutional documents) must have at least two parties; therefore, a corporation cannot be its own shareholder. *See* Israel Contracts Act § 2 (requiring the involvement of at least two persons for the formation of a contract). This is a broader, more exact principle than that invoked by Delaware law, which seeks mainly to prevent directors from voting the shares of the same corporation they are serving. In Israel, when a direct subsidiary corporation acquires shares issued by its parent, these become semi-vacant shares: they provide no voting rights, for similar reasons to Delaware's, while maintaining all other rights. *See* Israel Companies Act § 309(b).

[243] *See, e.g.*, DGCL § 220; Israel Companies Act §§ 184–187, 198a.

shareholder litigation.[244]

14. *Procedural aspects of shareholder litigation*. For example, when fiduciary law beneficiaries file a complaint in court (either themselves or through others, as in a derivative action), they may enjoy a shifted burden of proof, placed on the fiduciary-defendant.[245] The law recognizes that power and information asymmetries prevent administration of justice under the usual procedure, designed for arm's length disputes. These asymmetries are shared by all equity claimants, including shareholders. How do, or should, modified procedural rules apply to (non-derivative) shareholder claims?
15. *The relation between share law and the law of corporate purpose*. As discussed above, share law—and indeed, the very existence of shares and shareholders—is closely tied to questions of corporate purpose.[246] Under positive law, the for-profit corporation's purpose is the lawful pursuit of profit.[247] Shareholders have an equitable claim toward those profits, along with the rest of the corporation's net worth. This is widely known as "shareholder primacy," but in fact, it is simply the corporation, like a natural person, being allowed to lawfully act for its own benefit. Yet, there is an equitable sensitivity here: for example, if a legislature announced that corporations are no longer allowed to have profits, or that their assets must go to some stakeholders irrespective of their pre-existing rights, the corporation itself

[244] *See, e.g.*, Cal. State Teachers' Ret. Sys. v. Alvarez, 2017 Del. LEXIS 34, at *1 (Del. Jan. 18, 2017); Cal. State Teachers' Ret. Sys. v. Alvarez, 179 A.3d 824, 831 (Del. 2018) (decisions ultimately dismissing a derivative action filed in Delaware, on behalf of Walmart Inc., after the plaintiffs "did exactly what this Court has suggested on numerous occasions, namely, use the "tools at hand" to inspect the company's pertinent books and records before filing a derivative complaint." While the Delaware plaintiffs were engaged in the highly preliminary inspection stage, which "lasted nearly three years" due to defendants' resistance, a federal court dismissed a less factually detailed complaint, filed by other shareholders. On grounds of estoppel, this led to the dismissal of the Delaware complaint).

[245] *See, e.g.*, Michael W. Stockham & Mackenzie S. Wallace, *Fiduciary Duty Litigation and Burden Shifting*, ABA SECTION OF LITIGATION (Mar. 4, 2014), http://apps.americanbar.org/litigation/committees/trialevidence/articles/winter2014-0314-fiduciary-duty-litigation-burden-shifting.html [https://perma.cc/Z2ZU-LKMF] ("The entire fairness standard . . . [requires] the defendants to prove the entire fairness of the transaction . . . .").

[246] *See supra* pp. 273–75.

[247] *See supra* note 142.

might not be the only one harmed. Due to the nature of shareholders' claims, the effect of such a decision could be legally and equitably limited, and it might be successfully challenged, by the corporation as well as by shareholders.

16. *The relation between share law and corporate fiduciary law*. The two are distinct, but related. For example, when the law gives fiduciaries the power to commit certain acts, such as amending the constitutional documents, it also narrows shareholders' exercise of that power.[248] As another example, when a corporation is in *Revlon* mode, or other situations where directors' effect on shareholders is not channeled through the corporation, a direct relationship is formed between its directors and shareholders.[249] The interaction between the two fields also appears in situations where a shareholder, such as a controller, is considered to be a fiduciary.[250]

8. CONCLUSION

Classification and precision are important parts of any legal inquiry. Under-categorization or over-generalization can lead to serious difficulties in resolving actual issues, both in and out of court, involving very tangible rights. As Part 2 above details, the 2017 *Co-Op* case, which concluded a dispute concerning approximately US$15 million, is a clear-cut example of such an occurrence.

That case, and the legal conundrum it presented (before being correctly decided), illustrate how corporate law suffers from a persistent strain of under-analysis: as shown in Parts 3 and 4 above, we readily discuss issues of corporate fiduciary law, which is the law of the relationships between the corporation and its fiduciaries,

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[248] In Delaware, *see* DGCL § 109(a) ("[A]ny corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . ."). The bylaws exist along with and pursuant to the certificate of incorporation. *See* DGCL § 109(b). Moreover, any amendment to the certificate of incorporation can only be proposed by directors. *See* DGCL § 242(b). In Israel, fiduciaries cannot amend the company's article of incorporation; that power is always reserved to shareholders. Directors, as well as certain shareholders, can propose an amendment, but only the shareholder meeting may affect the change. *See* Israel Companies Act §§ 20, 57(1), 58(a), 66.

[249] *See supra* pp. 298–300.

[250] *See supra* note 164.

such as directors. Yet, we have not previously paid enough methodic attention to a separate field, also at the heart of corporate law: share law—the law of shares, shareholders, and their relationships with the corporation, with one another and with third parties.

Although they inform each other, share law is distinct from corporate fiduciary law. Part 5.4 above proves that for the most part, shareholders are not owed fiduciary duties. This distinction is practically significant, given the strict obligations, primarily the duty of loyalty, imposed by fiduciary law. Under established law, the corporation itself, not anyone else, is the object both of its fiduciaries' duties, and of shareholders' and other creditors' claims. Many corporate cases might involve no breach of fiduciary duty, yet, a substantial amount of wealth may be at stake.

Furthermore, Part 5 above reveals that *all* the jurisprudential sources regularly invoked to explain shares—two of them part of general "law" (contract and property), the other two offshoots of equity (trust and fiduciary law)—explain only parts or certain aspects of the share phenomenon; none does so fully or flawlessly. Because shares represent a *residual* claim, they inherently give rise to power and information asymmetries, a central factor making them impossible to address through "conventional" legal classifications. Yet, the total value of shares in the world, their importance in the modern economic structure and human life, and their prominence within the governance structure of every corporation, demand that we examine shares in a more coherent manner.

When no other source can explain the existence of, or govern the adjudication and resolution of questions relating to, certain legal phenomena, a "residual" normative framework applies: equity. From its origins to the present day, equity is designed to enable justice-making where it cannot be reached under "law"—in other words, through the classifications we are familiar with. Trust and fiduciary law are themselves branches of equity; yet, the properties of each preclude them from serving as the foundation of share law. We are left with equity itself. Unsurprisingly, the word "equity" is synonymous with "shares," and "shareholders' equity" has long been interchangeable with "the corporation's net worth," which is the size of the economic claim held by shareholders. As Part 6 above explains, shares and equity are related in multiple ways, and on the most fundamental level. In the case of shares, equity is not a "complement" or conscionable "exception" to contract and written law; rather, from the outset, equity is *the* core expectation of the parties to share-based relationships.

The nuanced understanding of corporate law, from which the concept of share law directly results, also informs other hotly debated topics: namely, corporate personhood and corporate purpose. The "shareholder/stakeholder" debate is often framed as a dichotomy, replete with catchphrases like "shareholder primacy," but this Article suggests there is a third way, strongly supported both positively and normatively: the corporation, a separate person, exists to achieve its own purpose, which is the lawful pursuit of profit; shareholders have an equitable (not proprietary or fiduciary, nor contractual) claim toward the corporation; by definition, as residual claimants, they rank below all other creditors or stakeholders—whose rights are determined outside of corporate law. It would be beneficial to consider how this more refined account might promote the resolution of that long-standing, high-stakes controversy.

Share law, equally with corporate fiduciary law, is a major field of classification within corporate law. It is the framework for conceptualizing, analyzing, and resolving share-related issues. These issues have existed since the emergence of corporations, but their legal treatment has been plagued with various theoretical, doctrinal, and practical misunderstandings. That kind of legal vacuum is not an unalterable fact of life. This Article, for the first time, proposes the concept of share law, allowing us to treat share-related issues comprehensively, within a well-defined legal paradigm, based on unifying principles, and capable of meeting the specific challenges that shares, by definition, give rise to. Through this lens, Part 7 above examines a multitude of high-currency topics encompassed by share law, including dividends and buybacks, aspects of mergers and acquisitions, appraisal rights, multiple-class equity, shareholder voting and activism, and shareholder litigation. Lawyerly, judicial, and scholarly inquiries into share law should continue, around the world, on a disciplined, methodic basis. Hopefully, this Article serves as a starting point for those facing other questions surrounding that unique creature of human enterprise, the corporate share.

A PURPOSE-BASED THEORY OF CORPORATE LAW

Asaf Raz*

Abstract

Modern corporate law scholarship focuses on flexible, dynamic questions: should multiple-class shares be permitted? To what extent should staggered boards be implemented? Even when making the more structural inquiry—what is a corporation, and what is its purpose?—corporate jurists tend toward generalizations: perceiving corporate law as either contract law, property law, or public law, and being either shareholderists ("shareholder primacy" advocates) or stakeholderists ("corporate social responsibility" advocates). In these accounts, fiduciary duties presumably run directly to shareholders or stakeholders. However, as this Article demonstrates, careful examination of corporate law (in Delaware and many other jurisdictions) reveals that all of these prevailing conceptions are, positively and normatively, inaccurate.

This Article offers a new paradigm through which to examine corporate law. It provides an integrative theory, fully congruent with both existing law and policy analysis, showing that corporate law is not any other field, but has its own structure, with uniquely beneficial economic and practical implications. At the heart of corporate law's anatomy is a simple, yet profound, fact: the corporation is a person with a purpose. The corporation itself has Hohfeldian relationships with its stakeholders, shareholders, and fiduciaries. The benefit of both stakeholders and shareholders is derived from the degree to which the corporation attains its purpose (for example, the lawful pursuit of profit). Directors and other fiduciaries, in turn, have an obligation to cause the corporation to achieve its purpose.

While corporate purpose, personhood, stakeholders, shareholders, and fiduciaries are all subjects of heated discussion, this Article is the first to tie them together, providing a fully self-explanatory picture of their mutual interactions. Doing away with both the "contract/property" and "shareholder/stakeholder" dichotomies, this Article applies the theory to several high-currency topics, including shareholder activism, corporations' constitutional rights, the rise of LLCs and other "alternative" corporations, mandatory arbitration, and Senator Warren's Accountable Capitalism Act. At each turn, the purpose-based theory of corporate law produces more refined conclusions, and charts a way forward—from conceptions devised in the 1980s, to a nuanced framework, capable of providing better answers to the many issues corporate law faces in its current state of flux.

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CONTENTS

INTRODUCTION

CORPORATE law[1] is in an identity crisis. Its two most fundamental questions—"what is a corporation?" and "what is the corporation's purpose?"[2]—are either answered very differently by different commentators, or (more often) not addressed at all. In the latter case, judges, lawyers, and scholars tend to focus on less structural and more modifiable issues, such as topics in corporate governance (from staggered boards, through shareholder activism, to dual-class shares), and treat them as if they *are* the entirety of corporate law.[3] The first two questions operate in the background, usually unspoken and "taken for granted." As a result,

1. In this Article, the terms "corporate law" and "corporation" are used in a broad sense, corresponding to what is often known as "business associations law" (an unsatisfactory phrase by itself, since some corporations have a non-business purpose). Other terms, such as "organizational law" (tying together both corporations and non-corporate organizations), are also inadequate. Corporations include more than the type of entity known as "corporation" in Delaware and similar jurisdictions, *see* Delaware General Corporation Law, DEL. CODE ANN. tit. 8, ch. 1 (2020). Rather, corporations encompass all entities that have the set of characteristics discussed in this Article. *See infra* Part I. These entity types include the Delaware "corporation," in addition to the company, cooperative, voluntary association, some partnerships, and others, as far as the range of corporate laws in a given jurisdiction allows. They include both for-profit and other-purpose corporations. *See* Asaf Raz, *Share Law: Toward a New Understanding of Corporate Law*, 40 U. PA. J. INT'L L. 255, 258 n.1 (2018) (utilizing the same approach). This is more than a linguistic issue: it is crucial for this Article's thesis, recognizing that all corporations have certain unifying traits, even if they differ in some details (such as the corporation's purpose, the title of its governing statute, or its internal governance rules). For similar statements, see VISA A.J. KURKI, A THEORY OF LEGAL PERSONHOOD 7 (2019) ("I use 'corporation' in the British sense, meaning 'artificial person'[, not the] American sense of 'large for-profit company.'"); Elisabeth de Fontenay, *Individual Autonomy in Corporate Law*, 8 HARV. BUS. L. REV. 183, 191 (2018) ("The 'corporation' . . . may be viewed as a compendium of different forms of organization, rather than as a single form. While these different forms comprise many overlapping terms and judicial doctrine, each has a core of distinct terms, supplied both by statute and by the common law."). If a reader so wishes, it is possible to substitute the term "entity" for "corporation" (while noting that, in the common usage of the word, many things besides corporations are entities). This Article distinguishes "corporations" in the narrow sense—mainly by referring to them in quote marks, for example, "Delaware corporation"—from corporations in the more general sense.

2. *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264 (1992) ("[T]he *most* basic questions [are:] What *is* a corporation? What purpose does it serve?"); David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 183 (2013) ("[The law of corporate purpose] is *the* most important issue in corporate law, and one of the most important questions in contemporary social organization.").

3. *See, e.g.*, John C. Coates IV, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 806 (1989) ("When people refer to 'corporate theory,' they are generally talking about one of three things. Most often, they are arguing about corporate governance and corporate behavior. Less often, they are raising the more abstract topic of corporate purpose . . . . Rarely, however, do they raise the most abstract issue of all: what is a corporation?" (footnotes omitted)).

the participants in the corporate law sphere are not speaking the same language;[4] each is "pulling the blanket" in a different direction, generating fragmented, ineffective discourse.[5]

Yet, these questions are more than theoretical. Diverging answers can lead to massively different outcomes for real-life problems. In fact, a proper understanding of corporate law's *structure*—the set of phenomena directly resulting from the concept of a "corporation,"[6] and attaching to *every* such entity—delineates the *boundaries* of the debate on each of the lower-level, dynamic choices. Interdisciplinary approaches, such as law and economics or law and society, are useful in determining whether, when, and how staggered boards or multiple-class shares (among many other debates) should be implemented. However, such discourse must exist within a certain framework, making clear *whose* welfare we are maximizing, who are the actors on the playing field, and who owes what kind of obligations to whom.

Today, the foundations of corporate law appear to be in flux, and not for the first time. The current landscape is largely reminiscent of the 1980s, when the "hostile takeover" wave ignited a wide-ranging debate on the fundamental nature of the corporation and its purpose.[7] A well-re-

4. Corporate law suffers from strong divergence even in regard to the *words* used by different judges, lawyers, scholars, and other participants. Consider the following: "agency costs," "business judgment rule," "company" and "corporation," "corporate" and "unincorporated," "corporate governance," "corporate social responsibility," "entrepreneurship," "equity," "fiduciary," "firm," "internal affairs," "nexus of contracts," "personhood" and "entity," "private ordering," "property" and "investor ownership," "separation of ownership and control," "shareholder primacy." Which of these terms do you use in your opinions, memoranda, or articles? In contrast, which appear redundant or unimportant? Rest assured, some think that *those* should be at the center of corporate law discourse. In fact, they might be discussing the very same issue, using different phrases. This miscommunication comes at an enormous cost to the corporate law community, since each participant must guess which terms the current audience is familiar with, and risk losing listeners' comprehension if different expressions are used. This Article offers a complete structural theory of corporate law, which enables all participants to correctly handle each of the concepts above (and many others), based on just five building blocks. *See infra* Part I.

5. *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1072 (2002) ("[T]he major participants in the debate seem to be talking past each other. . . . [T]heir basic conceptions are . . . fundamentally at odds . . . .").

6. In this regard, corporate law is similar to any other legal area. For example, contract law, at its core, is about the unmodifiable concepts attaching to the idea of a "contract." The contract itself cannot change what a contract is. On the distinction between higher-level, "structural" and lower-level, "dynamic" meanings, see *infra* notes 32–33 and accompanying text.

7. The roots of that controversy can be traced to the 1932 debate between Merrick Dodd and Adolf Berle. *See* E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) (advocating for a stakeholderist approach); A. A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) (defending a more shareholderist approach). However, for many following decades, the core questions of corporate theory did not

garded[8] article[9] by Chancellor William Allen—also one of the most important judicial figures of that period—delves into these questions, concluding there are just two possible answers. Allen calls them the "property" and "entity" conceptions.[10] In this Article they are referred to as *shareholderism* and *stakeholderism*, respectively. Consistent with Allen's dichotomy, modern corporate discourse generally perceives them as the only options, and most corporate jurists find themselves in one of these camps. By and large, shareholderism is associated with the law and economics movement,[11] while stakeholderism is advocated by those espousing more communitarian views.

According to shareholderists, the corporation is property—specifically, the property of its shareholders—or, at most, an aggregate ("nexus") of contracts, and its purpose is to increase shareholders' wealth.[12] A present-day illustration of this approach is the phenomenon of shareholder activism, particularly by hedge fund managers.[13] According to stakeholderists, the corporation is a person, or entity, separate from its shareholders; yet, unlike natural persons, the corporation is not free to lawfully pursue its own benefit—rather, it must promote the open-ended interests of various stakeholders (such as employees and consumers), beyond the rights they already have under non-corporate law.[14] A recent demonstration of this approach is Senator Elizabeth Warren's proposal to impose a legal duty on corporations to promote "general public bene-

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enjoy much salience—which the 1980s takeover wave changed. *See* Allen, *supra* note 2, at 263 ("The 1980s were turbulent years for corporation law. Twenty years earlier it had seemed that every interesting question in corporation law had been completely answered . . . ."); Coates, *supra* note 3, at 807 (stating, in a 1989 article, that "arguments over the nature of the corporation died several decades ago," but "[t]he legal concept of the corporation is currently in flux").

8. *See, e.g.*, Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 773 (2015) (calling Allen's article "a wonderful essay that all corporate law students should read, [in which] Chancellor Allen dilated on the two major traditions in American corporate law").

9. Allen, *supra* note 2.

10. *Id.* at 264.

11. This association is not exclusive. *See, e.g.*, K.J. Martijn Cremers, Scott B. Guernsey & Simone M. Sepe, *Stakeholder Orientation and Firm Value* (Dec. 27, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3299889 [https://perma.cc/SF9Y-66LN] (using empirical economic analysis to argue for stronger stakeholder orientation); Joel Edan Friedlander, *Corporation and* Kulturkampf*: Time Culture as Illegal Fiction*, 29 CONN. L. REV. 31, 61–114 (1996) (using historical, cultural, and theoretical analysis to argue for stronger shareholder rights).

12. *See, e.g.*, Allen, *supra* note 2, at 264–65, 266–70.

13. *See infra* Section II.A; *see also* William W. Bratton, *Hedge Fund Activism, Poison Pills, and the Jurisprudence of Threat*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 156, 156 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) ("Hedge fund activism is to corporate law's early twenty-first century what the hostile takeover was to its late twentieth century.").

14. *See, e.g.*, Allen, *supra* note 2, at 265, 270–72.

fit."[15] Neither conception ever won over the other;[16] shareholder activism and Senator Warren's proposal are two examples among many ongoing debates. As new battles unfold, the mysteriously repetitive pronouncements of corporate law's demise[17] will continue to turn out flatly mistaken. As Chancellor Allen proclaimed at the previous round, "[e]verything old became new again."[18]

The 1980s left us with two ways of thinking, and they divide the corporate law community to this day. It is time to ask: do we really have only these two to choose from? Are the underlying motivations of shareholderists and stakeholderists—economic and communitarian, respectively—actually served by what they say about corporate law?[19] As this Article reveals, corporate law itself—both positive law and normative analysis, in both Delaware and other U.S. and international jurisdictions—does not

15. Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018). Another recent stakeholderist proposal, garnering much scholarly and media attention, was the 2019 Business Roundtable statement. *See Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/S2LS-DSYN]. However, the Business Roundtable members (several corporations' fiduciaries) do not have any legal right or power to single-handedly "redefine" any corporation's purpose. That purpose is dictated by law, and can only be changed through law. By definition, just as corporations cannot lawfully breach the law, *see infra* Section I.C, and shareholders cannot lawfully receive more than what is left after the corporation meets all of its other obligations, *see infra* Section I.D, so are corporations legally required to act toward their purpose, *see infra* Section I.A, and their fiduciaries are legally required to cause them to do so, *see infra* Section I.E. Accordingly, this Article expands upon attempted *legal* reforms in the stakeholderist direction, not unilateral statements expressing subjective wishes that the law was different.

16. *See, e.g.*, Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1189–90 (2002) ("[T]he debate over the social role of the corporation remains unresolved.").

17. *See, e.g.*, Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962) ("[C]orporation law, as a field of intellectual effort, is dead in the United States. . . . We have nothing left but our great empty corporation statutes . . . . [These are] shivering skeletons."); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001); William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. 767, 789 (2017) ("Today's corporate legal theory centers on a small-scale policy discussion . . . . If anything, the scope of corporate legal theory will narrow even more. . . . [C]orporate law will look more and more like the rest of private law . . . ."); Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263 (2019).

18. Allen, *supra* note 2, at 264.

19. For the (negative) answer, see *infra* Section I.B (explaining how corporate personhood, and the overall structure of corporate law—which differs from contract or property law—promote the long-term, large-scale creation of economic value); *infra* text accompanying notes 151–52 (explaining how employees, consumers, and other stakeholders are always less well-protected by corporate law than by non-corporate law).

(and likely never did)[20] support *either* the shareholderist *or* the stakeholderist conception. Each view is correct on some issues, and errs on others.

This Article's account of corporate law is centered around a simple, yet profound, idea: the corporation is a person with a purpose. This statement has far-reaching implications. Contrary to both prevailing approaches, fiduciaries (such as directors and officers) owe their duties neither to shareholders, nor to stakeholders. In fact, their loyalty runs (and, under fiduciary law principles, *must* run) to one person: the corporation. Fiduciaries' mission is to cause the corporation to achieve its purpose—which might be the lawful pursuit of profit (in the case of for-profit corporations),[21] or any other lawful purpose (such as those of benefit and nonprofit corporations).[22]

In turn, *the corporation* owes various obligations to others, both stakeholders and shareholders. The protection of stakeholders[23] is embedded in the mandatory requirement that the corporation act lawfully, that is, meet all obligations under positive law[24] (which is mainly non-corporate

20. *See, e.g.*, *infra* text accompanying note 317 (quoting the 1847 case of *Smith v. Hurd*, fully conforming with the theory presented in this Article).

21. Indeed, being an entity does not necessarily entail being a "social" entity. *Cf.* Allen, *supra* note 2, at 271 ("[The] social entity conception sees the purpose of the corporation as not individual but social.").

22. Uniquely, corporate law provides no dictate as to *how* to achieve this; the corporation can do whatever it wishes to pursue this open-ended imperative, and possibly even fail in doing so, without facing legal sanction. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(a)(3) (2020) (stating that the corporation's goals might be "to engage in any lawful act or activity"); *infra* text accompanying notes 128–29, 151. This challenges the reliance, typical in corporate law and economics, on ex ante, "contract"-based planning. Corporate law might exhibit contract-like traits in *some* situations, but its main normative underpinning is equity. *See infra* Sections I.D (discussing equity-based share law), I.E (discussing corporate fiduciary law). Accordingly, ex post determinations and adjudication are necessary and beneficial; they are inherent to the corporate framework. Any attempt to operate on a fully "contractual" worldview ignores what corporate law is, resulting in both inefficiency (smaller pie) and unfairness (transfers of the pie to those who are not supposed to get it—usually, the stronger party, such as a corporation's fiduciaries).

23. The term "stakeholder" most broadly refers to *any* person having a relationship with the corporation, including non-residual claimants, residual claimants (mostly known as "shareholders"), and fiduciaries. *See* R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 46 (1984) ("A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives."). However, this Article employs a narrower definition, where "stakeholder" is any person with Hohfeldian claims vis-à-vis the corporation, *except* for residual claimants and fiduciaries. That is because the latter two categories involve unique issues, which only corporations give rise to, and which are treated within corporate law itself. Therefore, each of the three categories is considered in a separate section of this Article. *See infra* Sections I.C, I.D, I.E. In common usage, "stakeholder" typically denotes the first category only. It also seems preferable to "creditor" (used in the same sense in an earlier article, *see* Raz, *supra* note 1) or "non-residual claimant."

24. In this Article, "positive law" denotes the entire set of binding norms, as opposed to *wishes* on what corporations might owe to certain people, or not owe to

law—such as contract, employment, or environmental law). The rights of residual claimants (or shareholders) derive from the open-ended part of the corporation's purpose—for example, "the pursuit of profit." Since that purpose must always be pursued lawfully, shareholders have the most *subordinated* claim toward the corporation; the phrase "shareholder primacy" is counterfactual. Shareholders' rights are not proprietary or fiduciary, but also not merely contractual. They are a unique product of corporate law itself.

Therefore, corporate law consists of five building blocks: purpose, personhood, stakeholders, residual claimants, and fiduciaries. These, and their mutual interactions, form the structure of corporate law. This structure is unique to corporate law: a natural person can have neither directors, nor shareholders. Modifying the *content* of one pillar does not alter its very presence, nor the other elements. A nonprofit corporation has a different purpose than a for-profit corporation; yet, both are legal persons, both are required to meet all of their legal obligations, both have residual claimants with equitable rights, and both are entitled to have their fiduciaries loyally promote the corporation's purpose. A corporation's managing body may be staggered or not, comprised of inside or outside directors, or be called a board of "managers" or "trustees" rather than "directors"; in any case, its members owe *fiduciary* duties *to the corporation*—direct results of the structure of corporate law.[25] An identical set of economic, practical, and legal questions arise with respect to *any* corporation. The theory holds across time and jurisdictional boundaries, and is not subject to "private ordering"; it is the foundation *upon which* contracting occurs. Nor can it be legislated around: if a statute truly eliminated one of the building blocks, the resulting phenomenon would not be a corporation.

This Article proceeds as follows: in Part I, the purpose-based theory of corporate law is presented in five sections, corresponding to the building blocks of corporate law (purpose, personhood, stakeholders, residual claimants, and fiduciaries). Because present-day corporate law is mainly split between shareholderist and stakeholderist views, as described above, care is taken to introduce the new theory in terms of how it diverges from, or builds upon, our existing conceptions. Part II applies the theory to

others, or what the law "ought" to be. *See, e.g.*, Strine, *supra* note 8, at 790 ("For those who decry [certain behaviors by corporations], the solution must come from . . . bodies of positive law that constrain corporate behavior . . . and cannot rationally rest on calls for corporate directors to 'be patriotic.'"). Positive law encompasses a very broad set of norms. It includes equity, *see infra* note 308, and it may even include disobedience, when certain "laws" are unjust (or plainly unlawful) according to some other normative source (such as human rights, or simple reason). For a discussion of situations where disobedience might be lawful in some sense, see Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 731–48 (2019).

25. *See infra* text accompanying notes 212–17 (discussing the fact that, due to the corporation being an artificial person, it must always have a natural person acting on its behalf and for its benefit).

three high-stakes policy issues: shareholder activism, the *Citizens United v. FEC*[26] and *Burwell v. Hobby Lobby Stores, Inc.*[27] decisions, and the rise of LLCs and other alternative corporations. In each case, the purpose-based theory leads to more refined, often pointed, conclusions.

Not only is corporate law not "dead,"[28] it is more important than ever. Yet, modern corporate law "seems to be in insoluble theoretic disarray, with scholars scrambling to assemble a giant puzzle of ill-fitting pieces."[29] This Article assembles the puzzle of corporate law.

I. THE TRUE ANATOMY OF CORPORATE LAW

Questions of structure and anatomy serve an important function in any legal discipline. These structural inquiries attempt to discern what is common to *all* members of a certain group, and how these phenomena interact with one another. In legal terms, this primarily gives rise to questions such as: what types of Hohfeldian rights and duties does a given actor have, and toward whom?[30] Which legal "toolboxes"—sets of rules, principles, and doctrines—govern each actor or situation?

Structural inquiries exist on a higher hierarchical level than the various resolutions made *within* each toolbox, which are dynamic and changeable, as opposed to the structure itself. For example, even if the rules of "capital lock-in" (which restrict shareholders' ability to withdraw assets from the corporation at will) are different among jurisdictions,[31] at least two building blocks are constantly present: "shareholder" and "corporation." Professors Balganesh and Parchomovsky describe this as the distinction between "structural" (or "jural") and "normative," dynamic meanings.[32] While "[t]he jural meaning refers to the structural core undergirding a legal concept," "[t]he normative meaning refers to the meaning that . . . [the] concept . . . come[s] to be cloaked in as a result of

26. 558 U.S. 310 (2010).

27. 573 U.S. 682 (2014).

28. *See supra* note 17 and accompanying text.

29. Abraham Bell & Gideon Parchomovsky, *A Theory of Property*, 90 CORNELL L. REV. 531, 533–34 (2005).

30. *See* Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913).

31. *See* Mariana Pargendler, *How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil*, 58 COLUM. J. TRANSNAT'L L. 1, 9–19 (2019) (describing a trend in Brazilian courts of allowing shareholders, under certain circumstances, to redeem their shares, even when the corporation is not in liquidation proceedings; also viewing this as a divergence from normal "corporate law"). As the discussion here demonstrates, even if some *dynamic* choices in Brazil's corporate law are unique, it is still corporate law, and the entities it governs are corporations.

32. Shyamkrishna Balganesh & Gideon Parchomovsky, *Structure and Value in the Common Law*, 163 U. PA. L. REV. 1241 (2015). In that context, the term "dynamic" is substituted here for "normative," simply because legal theorists mostly use "normative" as the opposite of "positive," which differs from Balganesh and Parchomovsky's usage.

external interpretive influences, which may in turn be drawn from a variety of situational goals."[33] Applying this to our example, the fixed *structure* ("shareholder" and "corporation") is required for us to discuss the *dynamic* question ("when should a shareholder be allowed to withdraw assets from the corporation?").

Within corporate law, the leading work in this area is Professor Reinier Kraakman and co-authors' *The Anatomy of Corporate Law*.[34] As that book argues, every corporation presumably has five "defining characteristics":[35] legal personality, limited liability, transferable shares, delegated management with a board structure, and investor ownership.[36] One may ask, however, why *these* five? Indeed, "*The Anatomy of Corporate Law* does not offer any general theory as to how the various elements of its typology fit together."[37]

This Part of the Article fills that gap. It reveals that only one of the five characteristics—corporate personhood—is a necessary feature of *all* corporations.[38] Other characteristics can be contracted around or otherwise modified. A corporation might feature non-limited liability;[39] non-transferable shares;[40] non-delegated management;[41] and a non-financial investor (say, an employee) as its residual claimant.[42] All these do not make the entity any less of a corporation. In other words, the latter four characteristics are modifiable, *dynamic* choices; they do not define any of the invariable, *structural* issues generated by the concept of the corporation.

33. *Id.* at 1244.

34. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (3d ed. 2017).

35. *Id.* at 31.

36. *Id.* at 5–15.

37. David A. Skeel, Jr., *Corporate Anatomy Lessons*, 113 YALE L.J. 1519, 1540 (2004) (book review).

38. The authors of *The Anatomy of Corporate Law* make a similar statement. *See* KRAAKMAN ET AL., *supra* note 34, at 31 ("[O]f the five defining characteristics of the corporate form, only one—legal personality—clearly requires special rules of law. The other characteristics could, in principle, be adopted by contract . . . ." (footnote omitted)).

39. *See, e.g.*, Companies Act 2006, c. 46 § 3(4) (UK) (allowing for a company with "no limit on the liability of its members").

40. *See, e.g.*, MODEL BUS. CORP. ACT § 6.27(a) (AM. BAR ASS'N 2016) ("The articles of incorporation, the bylaws, an agreement among shareholders, or an agreement between shareholders and the corporation may impose restrictions on the transfer or registration of transfer of shares of the corporation.").

41. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-402 (2020) ("Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members . . . ."). Even in regard to a narrow-sense "Delaware corporation," the same person can be both shareholder and fiduciary. *See, e.g.*, *infra* Section II.A. In a private corporation, there might be no delegation of management at all.

42. *See, e.g.*, tit. 8, § 152 ("The board of directors may authorize capital stock to be issued for consideration consisting of cash, any tangible or intangible property or any benefit to the corporation, or any combination thereof.").

This Part provides a new, more refined account of corporate law's anatomy, which applies to *every* corporation. This inclusivity is possible because the theory relies on a set of highly fundamental notions (for instance, the concept of equity, or Hohfeldian rights and duties), which cannot be contracted or legislated away. As explained below, the five building blocks of corporate law are purpose,[43] personhood,[44] stakeholders,[45] residual claimants,[46] and fiduciaries.[47] They are structurally related to one another, and particularly to the first building block—the corporation's purpose.

This account resolves the "blanket pulling" problem described at the beginning of this Article,[48] as it provides a *complete* map of corporate law's structure. For example, a commentator might recognize corporate personhood, yet believe that shareholders have purely "contractual" rights, or that the corporation is a creature of public law;[49] the structure presented here confirms the first and corrects the latter two. Consistent with this objective, much of the discussion in this Part directly addresses, and corrects, various misconceptions encountered in the corporate law community. Among other contributions, this more precise anatomy provides an alternative to the shareholderist–stakeholderist dichotomy. It also responds to other inaccurate, seemingly exclusive choices, such as between "contract" and "property" theories of the firm. Moreover, as Part II below illustrates, this theory allows us to better understand and address a wide range of current policy issues.

A. *The Corporation's Purpose*

Every corporation has a purpose. Corporations, which are legal persons,[50] are similar in this regard to natural persons (humans), also operating to achieve a certain life purpose. A human may have a mix of life purposes, and easily change them by simple choice. One may wish to live for the pursuit of economic profit one day, and move to a communal village the next. This fundamentally arises from the fact that a human being is an end in oneself, with complete freedom to pursue happiness, within the bounds of law.

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43. *See infra* Section I.A.

44. *See infra* Section I.B.

45. *See infra* Section I.C.

46. *See infra* Section I.D.

47. *See infra* Section I.E.

48. *See supra* text accompanying notes 3–5.

49. *See* Jonathan Macey & Leo E. Strine, Jr., Citizens United *as Bad Corporate Law*, 2019 WIS. L. REV. 451, 458–77, 483–85. For an example of "blanket pulling" in the opposite direction, see Robert Anderson IV, *A Property Theory of Corporate Law* (July 17, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3421009 [https://perma.cc/AM7G-LR2V] (correctly noting that shareholders are unique claimants and have more than contractual rights, but incorrectly viewing shareholders' claims toward the corporation or its assets as property rights).

50. *See infra* Section I.B.

In contrast, a corporation cannot feel happiness, at least not in the human sense. It is a legal person, whose existence is meant to increase human well-being,[51] albeit only through the concept of corporate personhood and the overall structure of corporate law. Also, lacking its own physical faculties, the corporation's purpose *must* be determined by *other* people—initially, its founders.[52]

The most important difference between corporations and humans is that the former have a specific, non-easily-modifiable purpose.[53] As Professor Adam Winkler notes, "corporations are not truly 'free' in the way that individuals can be. A [natural] person can choose her own values, preferring to prioritize personal wealth, social welfare, the environment, or law and order. A [for-profit] corporation, however, is legally obligated to prioritize profit, at least in the long term."[54]

Over the last few years, growing attention is being paid to the idea that the core concept of corporate law—the building block around which all others, including personhood, fiduciaries' duties, and stakeholders' and shareholders' rights, are arranged—is purpose (rather than "contract," "property," or "fiduciary law"). Corporate purpose, and its place in the matrix of corporate law, is the subject of rapidly expanding scholarship.[55] Recent papers by Professors Paul Miller and Andrew Gold discuss purpose within a broader inquiry of corporate law's structure; similarly to this Article, these texts (part of the New Private Law movement) employ an integrative approach, demonstrating that corporate law is not any other field, but has its unique identity, combining numerous legal concepts and traditions.[56] Many of these works, however, are written from a

51. *See, e.g.*, Elizabeth Pollman, *Reconceiving Corporate Personhood*, 2011 UTAH L. REV. 1629, 1663 ("[W]e owe no allegiance to corporations . . . without reference to the idea that people are involved.").

52. *See* Raz, *supra* note 1, at 273–74 (discussing founders' role in setting the corporation's purpose), 275 ("[D]ue to the limits of the corporation's physical nature, there is simply no way it *could* determine its own purpose and goals without other people, and the choices they make.").

53. In some cases, that purpose might not be easily determined ex ante. This Section argues that at least in the most ubiquitous type of corporation—the for-profit corporation (as well as many types of nonprofit corporations)—it can.

54. ADAM WINKLER, WE THE CORPORATIONS 388 (2018).

55. *See, e.g.*, Andrew S. Gold, *Purposive Loyalty*, 74 WASH. & LEE L. REV. 881 (2017); Lyman P.Q. Johnson, *Relating Fiduciary Duties to Corporate Personhood and Corporate Purpose*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 260 (D. Gordon Smith & Andrew S. Gold eds., 2018); David Ciepley, *Corporate Directors as Purpose Fiduciaries: Reclaiming the Corporate Law We Need* (July 29, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3426747 [https://perma.cc/7C4Y-JFSP].

56. *See* Paul B. Miller, *Corporations*, *in* THE OXFORD HANDBOOK OF THE NEW PRIVATE LAW (Andrew S. Gold, John C.P. Goldberg, Daniel B. Kelly, Emily L. Sherwin & Henry E. Smith eds., forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3432033 [https://perma.cc/4KXQ-XYV6]; Paul B. Miller & Andrew S. Gold, *The Corporation as a Category in Private Law*, *in* RESEARCH HANDBOOK ON PRIVATE LAW THEORIES (Hanoch Dagan & Benjamin Zipursky eds., forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3453744 [https://perma.cc/J6XN-RXNA].

stakeholderist perspective—essentially contrasting a "purpose" approach with "shareholder primacy"—or choose not to elaborate on what *is* the corporation's purpose, instead only stating (correctly) that, whatever it is, it shapes fiduciaries' duties.

This Article takes the next steps: first, in the remainder of this Section, it expands on the term "purpose" in corporate law, and provides a positive and normative overview of the purpose of for-profit and other corporations. It then relates purpose to the other four building blocks of corporate law, all arranged around the corporation's purpose: personhood allows the corporation to achieve its purpose better than through any non-corporate framework;[57] stakeholders enjoy the requirement to obey positive law, embedded in the corporation's purpose (hence, there is nothing wrong, and certainly not legally actionable, with a lawful profit-seeking purpose);[58] the rights of residual claimants are derived from, and related via equity to, the corporation's pursuit of its purpose;[59] and fiduciaries' duty is to act so that the corporation achieves its purpose.[60] This Article does not aim to discuss every question pertaining to corporate purpose, of which there are many.[61] Rather, it provides a theory of corporate law as a whole, with purpose at its center.

The term "purpose" itself requires elaboration. The corporation's ends are determined on two different levels. The higher is what this Article calls "purpose," which is a somewhat more general statement—for example, "the lawful pursuit of profit"—provided by law, and attaching to a certain *form* of corporation. The lower level is what may be called the corporation's "goals"—for example, "to engage in construction" or "any lawful activity"—which are flexible choices, appearing in the corporation's constitutional documents, and possibly changing from one corporation to another, even if both are of the same form. Some corporate statutes, including Delaware's, refer to the corporation's goals as its "purpose,"[62] but the difference is legally and practically significant.[63]

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57. *See infra* Section I.B.

58. *See infra* Section I.C.

59. *See infra* Section I.D.

60. *See infra* Section I.E.

61. Such questions include, among others: who should be able to set the corporation's purpose? Who should decide whether or not the corporation is acting toward its purpose (shareholders, fiduciaries, courts, or someone else)? How can corporations' purpose be encapsulated in one sentence (such as "the lawful pursuit of profit"), a much more compact purpose compared to that of human beings? How and to what extent can purpose be contractually determined or modified? While the answers are often quite clear under positive law, they leave much room for policy debate.

62. DEL. CODE ANN. tit. 8, § 102(a) (2020) ("The certificate of incorporation shall set forth: . . . The nature of the business or purposes to be conducted or promoted. It shall be sufficient to state . . . that the purpose of the corporation is to engage in any lawful act or activity . . . .").

63. *See* George A. Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1364–68 (discussing the difference between "strategic" and "tactical" cor-

As suggested by the very existence of distinct terms, such as "non-profit corporation," "cooperative," "voluntary association," and "for-profit corporation," these different forms have different purposes, and in the case of the latter, it is the pursuit of profit (which, as shown here, invariably means the *lawful* pursuit of profit). From a legal standpoint, there is nothing wrong with a person lawfully pursuing its own benefit: as Section I.C below explains, no legal sanction can be imposed on a corporation that acts in full accordance with law; this also means that the corporation is free to pursue profit, as long it does not harm anyone else in any legally sanctionable manner. Indeed, a promoter establishing a new for-profit corporation buys a "prepackaged product,"[64] at least in part, and one of its provisions is the corporation's purpose. A change of corporate form (and purpose) is possible, but it must be done in a manner assuring that the corporation still complies with all of its legal and equitable obligations.[65]

This simple statement—that the first part of the corporation's purpose ("lawful") encompasses, by definition, all the protection stakeholders are legally entitled to, and the second part (such as "pursuit of profit," or any other, once it is determined) can therefore not be subject to legal challenge—provides a strong normative justification for corporations' license to pursue their own benefit. How do we know that, under positive law, the for-profit corporation's purpose truly is the lawful pursuit of profit? In Delaware, no section of the main corporate statute[66] explicitly says so. This fact, however, can be clearly inferred from a variety of case law and other sources, including formative cases of Delaware law.

For instance, 1989's *Paramount Communications, Inc. v. Time Inc.*[67] decision is generally regarded as a victory for the stakeholderist side. In that case, shareholder-plaintiffs failed to prevent a corporation, through its board of directors, from implementing defensive measures meant to block a high-premium, hostile tender offer. The decision itself, however, reveals a more nuanced picture. The court discusses *the corporation's* purpose—as distinct from those of both its shareholders and stakeholders—and concludes it is the pursuit of profit:

porate purpose, similar to the distinction made here between "purpose" and "goals").

64. *See, e.g.*, Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 846–47 (2008) ("[M]andatory terms guarantee that certain core qualities are associated with the particular 'brand' of business entity called a 'Delaware corporation.' The existence of that brand benefits all Delaware corporations by saving the expense investors would otherwise incur to investigate whether a particular entity had or lacked any of those core qualities." (footnote omitted)).

65. This requires the consent of those who have the authority to determine the corporation's purpose—initially, its founders, and later the corporation's residual claimants, to whom the founders' authority passed, *see* Raz, *supra* note 1, at 273 n.75. For detailed discussion of this point, see *infra* note 209 and accompanying text.

66. Delaware General Corporation Law, tit. 8, ch. 1.

67. 571 A.2d 1140 (Del. 1989).

> Delaware law imposes on a board of directors the duty to manage the business and affairs *of the corporation.* This broad mandate includes a conferred authority to set a *corporate* course of action . . . *designed to enhance corporate profitability*. . . . [D]irectors, generally, are obliged to charter a course for a corporation which is in *its* best interest . . . .[68]

The *Paramount v. Time* court does not elaborate much on where the profit-enhancing mandate comes from. Yet, even in a case shareholders *lost*, the nature of the corporation's own purpose seemed indisputable to the court.

In the well-known footnote 55 to his *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*[69] decision, Chancellor Allen presents, in great arithmetic detail, a situation where the corporation's economic interests diverge from those of *any* natural person—both shareholders and stakeholders. As the Chancellor then remarks,

> [The optimal] result will not be reached by a director who thinks he owes duties directly to shareholders only. It will be reached by directors who are capable of conceiving of the corporation as a legal and economic entity. . . . [C]ircumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.[70]

Credit Lyonnais directly invokes two of corporate law's building blocks—personhood and fiduciaries—and correctly concludes that directors' duties run to the corporate person. Although Chancellor Allen does

68. *Id.* at 1150 (citation omitted) (emphases added).

69. No. 12150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991).

70. *Id.* at *108 n.55. Chancellor Allen writes that directors' duties run to the entity "[a]t least where a corporation is operating in the vicinity of insolvency," *id.* at *108, but not much in his substantive analysis turns on this; whether solvent, close to insolvency, or insolvent, the corporation is supposed to act to increase (or, at a minimum, protect) its net worth. The words "at least" in the Chancellor's opinion are meaningful, given the many other Delaware cases surveyed throughout this Article (including landmark cases such as *Paramount v. Time*), which discuss fiduciary duties to the corporation itself, yet did not arise in vicinity to insolvency. For detailed discussion of this point, see *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 792 (Del. Ch. 2004) (clarifying, among other things, that "the fact of insolvency does not change the primary object of the director's duties, which is the firm itself"). The leading Delaware authority stating this position (while extensively citing *Production Resources*) is *North American Catholic Education Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 101–03 (Del. 2007) ("It is well settled that directors owe fiduciary duties to the corporation [either when it is solvent or insolvent]. . . . [D]irectors . . . have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation.").

not explicitly mention "purpose," his economic analysis (preceding the above quote) makes clear that, in the first place, the corporation is there to pursue a certain purpose—the maximization of its own economic value—and, in turn, directors' role is to cause the corporation to do precisely that.

Moving into the computer age, 2010's *eBay Domestic Holdings, Inc. v. Newmark*[71] decision proceeds similarly to *Paramount v. Time* and *Credit Lyonnais*: it does not engage in deep-level analysis of the normative justifications for the lawful pursuit of profit, yet, it states that this purpose does attach to the for-profit corporation. As the court plainly remarks, "I cannot accept as valid . . . a corporate policy that . . . seeks *not* to maximize the economic value of a for-profit Delaware corporation."[72] In another case involving a technology company, 2013's *In re Trados Inc. Shareholder Litigation*[73] decision states as follows:

> [Directors' decisions should] benefit the corporation as a whole . . . by *increasing the value of the corporation* . . . . [T]he duty of loyalty therefore mandates that directors *maximize the value of the corporation* over the long-term . . . . [R]esidual claimants [are] the *ultimate* beneficiaries of *the firm's* value . . . .[74]

As Section I.E below also discusses, *Trados* makes clear both that the corporation's purpose is the lawful pursuit of *its* profit (or "value"), and that this is separate from the effect on shareholders, who only ultimately and conditionally—through the structure of corporate law—gain any benefit from the corporation's success.

Indeed, both *Paramount v. Time* and *Trados* are cases in which *shareholders* lost, but *the corporation's* purpose was determined to be the lawful pursuit of profit. This clarifies the difference between the purpose-based theory, presented here, and so-called "shareholder primacy," or shareholderism generally. Shareholders, who are fully distinct from the corporation, might not see any direct blessing in the corporation's profits. A for-profit corporation might, for example, engage in building space launch systems (as a certain well-known Delaware corporation does),[75] undoubtedly a long-term, large-scale, capital-intensive mission. Corporate law mandates that the corporation's profits and assets are its own—not its shareholders'—and any access to them by shareholders is constrained by the facts of corporate law (for example, the corporation's discretion as to whether or not to distribute a dividend, or its ability to deploy defensive measures against a takeover). Thus, even over an extremely long period,

71. 16 A.3d 1 (Del. Ch. 2010).

72. *Id.* at 34.

73. 73 A.3d 17 (Del. Ch. 2013).

74. *Id.* at 36–41 (emphases added).

75. *See* Raz, *supra* note 1, at 288 n.130 and accompanying text (discussing Space Exploration Technologies Corp., also known as SpaceX, in a similar context).

the corporation's profit-seeking purpose can benefit the corporation, and allow it to continue developing and expanding its operations—but not, in any immediate or tangible way, its shareholders. The latter have an equitable, more-than-contractual claim toward the corporation, and are entitled to its profits when it either decides to distribute them, or dissolves.[76] That claim, however, does not result in anything that can be called "shareholder primacy." It exists within a framework—corporate law—that promotes the corporation's pursuit of its own purpose.

B. *The Corporation's Personhood*

Every corporation is a person.[77] This says a lot about what the corporation is *not*: while others have suggested that the corporation might be "property,"[78] an "aggregate" of other people,[79] a "nexus" of contracts,[80] a "concession" from the state,[81] or a "mediating hierarchy,"[82] none of these models fully cohere with the corporation's true nature. In short, the cor-

76. *See infra* Section I.D.

77. *See, e.g.*, KRAAKMAN ET AL., *supra* note 34, at 5–8 (discussing "[l]egal personality" as a "core structural characteristic[ ]" of the corporation); Raz, *supra* note 1, at 286 n.120 (citing a broad range of statutory, case law, and scholarly sources to that effect); *infra* text accompanying note 317.

78. *See, e.g.*, Allen, *supra* note 2, at 264–65 ("In the first conception, the corporation is seen as the private property of its stockholder-owners."); Katsuhito Iwai, *Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583, 592 (1999) ("[W]hat does a corporate shareholder own? The corporation, of course. It is the corporation itself as a 'thing' that a corporate shareholder legally owns."). For a refutation of the property model, see, for example, Raz, *supra* note 1, at 285–87.

79. *See, e.g.*, VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS OTHER THAN CHARITABLE 2 (1882) ("[T]he rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being."), *quoted in* Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1458 (1987). The "aggregate" and "property" views, *see supra* note 78, although not identical, are closely related. *See, e.g.*, Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 42 (2000) ("The aggregate or partnership model of the corporation, which was prevalent in the 19th century, assumed [a role as the 'owners' of the corporate enterprise] for shareholders . . . ." (footnote omitted)).

80. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302 (1983) ("An organization is the nexus of contracts, written and unwritten, among owners of factors of production and customers."); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) ("The private corporation or firm is simply one form of *legal fiction which serves as a nexus for contracting relationships* . . . .").

81. *See, e.g.*, Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819) ("A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it . . . ."); *see also* Coates, *supra* note 3, at 810–15 (discussing the artificial entity theory in detail), 831 (explaining how the artificial entity theory lost valence in modern reality).

82. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 276–87 (1999).

poration is not a collection of anything—people, assets, contracts, or rights. Every corporation is one, single entity. Other people can make contracts with, or have rights toward (not "in") the corporation, which owns its assets, and itself is unownable.[83] Each of the other views can have some intuitive appeal, in some situations, but only this simple statement—the corporation is a person—*consistently* adheres to law and day-to-day reality. A nexus of contracts cannot own property or make new contracts, only a person can;[84] the concession theory has nothing to do with the way corporations come into existence today;[85] the mediating hierarchy concept might explain how the corporation's fiduciaries ought to make decisions, but does not describe the nature of the corporation itself; and so on.

The unifying motive behind the various inaccurate models of the corporation, mentioned above, might be very simple: to some, the sentence "the corporation is a person" sounds plain strange. After all, humans are persons, and other things are not, correct? Not exactly. The corporation is a product of a certain field of law, administered by humans. The same is true of any other legal concept, including "right," "duty," "property," "contract" and "person." The corporation is a *legal* person, not a human.[86] As a rule, the corporation has the *legal* capacity of a human.[87] Assuming that the law's overarching aim of promoting human well-being is pursued, law is capable of making a certain phenomenon into a person, or "right-and-duty-bearing unit."[88] The corporate person is no more a "fiction" than law itself is a fiction.

83. *See, e.g.*, Raz, *supra* note 1, at 286 ("Shareholders do not own the corporation; they own shares. While it is meaningful to discuss the ownership of a *right toward* a corporation, it is unclear what might it mean . . . to 'own' a corporation—another person, with interests and volition of its own." (footnote omitted)).

84. *See, e.g.*, *id.* at 284; *infra* note 221 and accompanying text.

85. *See infra* note 283 and accompanying text.

86. This differs, for example, from Otto von Gierke's more extreme views. *See, e.g.*, Friedlander, *supra* note 11, at 40 ("In the late nineteenth century, the eminent German legal historian Otto Gierke theorized that when individuals unite, spiritually and psychologically, for a common purpose they create a separate, living person that has a will of its own." (footnote omitted)), 76–83 (discussing in detail Gierke's "Theory of the Corporation as Group-Person" and its spiritual and collectivist allusions).

87. Some corporate statutes say so explicitly. *See, e.g.*, 15 PA. CONS. STAT. § 1501 (2020) ("[A] business corporation shall have the legal capacity of natural persons to act."). There are things humans can do and corporations cannot—some, because allowing them contradicts our understanding of other legal and social institutions (for example, voting in the general election); and some, because the corporation inherently lacks certain traits, *see, e.g.*, *In re* Dole Food Co., 110 A.3d 1257 (Del. Ch. 2015) (preventing a corporation from serving as an expert witness). These are exceptions; the rule is that a corporation has the legal capacity of a natural person. This fact is supported by other parts of corporate law's structure, namely, the existence of fiduciaries—humans through whom the corporation operates in the physical world. *See infra* Section I.E.

88. John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655 *passim* (1926).

To those for whom corporate personhood seems morally appalling, three responses may be offered: first, corporate personhood has been devised by humans, is ultimately meant to benefit them, and in fact does so, as evidenced by The New York Times Company not going out of business every time one of its shareholders dies. Second, by their own communitarian standard, these objectors do not offer a compelling alternative; would it be better if the corporation was "owned" by its shareholders? Third, the objectors' true discontent seems to be with the things *some* corporations do—for instance, funnel excessive amounts of money to support political candidates[89]—and not with corporations' ability to do *anything* at all, while bearing their own rights and duties (including the duty to obey the law[90]).

The question, then, is *why* must every corporation be a person? Why cannot at least some corporations, on the basis of either state law or private ordering, be something else, say, an aggregate of shareholders? The answer lies at the most definitional level. What distinguishes *corporate* law is the existence of a *corpus*, or "body"—the corporate person.[91] Far more than a linguistic matter, the presence of a distinct legal person, bearing its own rights and duties, allows corporate law to produce a unique set of doctrinal, economic, and practical benefits.[92] In turn, corporate law's unique benefits enable the corporation to achieve its purpose (for example, the lawful pursuit of profit) better than any mechanism provided by other legal frameworks. Therefore, the law of corporate personhood can be viewed as a means to an end—the promotion of the corporation's purpose. Corporate personhood, like corporate law's other building blocks, revolves around corporate purpose.

Although a group of individuals can act toward a common purpose, we are then not in the realm of corporate law; at most, we are dealing with non-corporate partnership law,[93] contract law, or trust law. Each of these come with their own doctrines, economic implications, and practices, distinct from those of corporate law. For example, the human actors (or at least one of them) can never enjoy full limited liability: lacking a separate person to which duties attach, the individuals themselves bear those duties.

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89. *See infra* Section II.B.

90. *See infra* Section I.C.

91. *See* Macey & Strine, *supra* note 49, at 478 ("The very term 'corporation' derives from the Latin word corpus which translates into English as the word 'body,' which presents an entity that is authorized by the state to act as an individual.").

92. *See, e.g.*, *id.* at 526 ("Unless such a separate entity is created . . . the basic objective of the corporation, which is to create an economic framework for amassing capital to be deployed in economic activity, cannot be reached."); de Fontenay, *supra* note 1, at 201 ("Recognizing the corporation as the owner of [its] assets . . . is one of the defining features of the corporation and the key to its success in fostering economic growth precisely because it prevents individual shareholders from removing productive business assets at will.").

93. *See infra* note 272.

On the flip side, just as shareholders are offered limited liability, the existence of a separate person—having its own characteristics and rights (in addition to duties)—means that other individuals' wishes and purposes are *not* those of the corporation,[94] and that fiduciary duties run to the corporation, not to shareholders or stakeholders.[95] Indeed, one of the main justifications for having corporate law in the first place, *as opposed to* contract, property, trust, or general fiduciary law, is that unlike these frameworks, corporate law serves to *limit* each individual's freedom of action,[96] thus promoting a purpose that is not fully congruent with, or under the control of, any of the involved human actors.

It is therefore puzzling to see many scholars, particularly on the shareholderist, or law and economics side, write about corporate law as if it was concerned with an agency problem between only two actors, managers and shareholders.[97] This kind of scholarship inexplicably ignores the one person at the heart of corporate law: the corporation. The amelioration of agency costs is the focus of much of corporate law; yet, these agency problems are mainly between *the corporation* and its fiduciaries. Crucially, the corporate person also does not have identity of *interests* with its shareholders: multiple "agency problems," as well as legitimately differing interests, exist *between shareholders and the corporation*, distinct from the agency problems between the corporation and its fiduciaries.[98] Put simply, "the corporation's fortunes might *not* translate into those of its share-

94. *See supra* Section I.A.

95. *See infra* Section I.E.

96. *See* de Fontenay, *supra* note 1, at 195 ("[A] core goal of corporate law is to . . . *constrain* individual behavior. For this reason, it is a comparatively poor choice of regime in which to expand individual rights." (emphasis added)), 197 ("[C]orporate law serves to quash individual voices and actions *by design* . . . ."). Of course, the *ultimate* aim of corporations (and corporate law) is to enhance human well-being. *See, e.g.*, Pollman, *supra* note 51, at 1663. Precisely to this end, corporate legal mechanisms constrain involved actors' behavior (as *all* law does; corporate law more structurally and evenhandedly so).

97. *See, e.g.*, KRAAKMAN ET AL., *supra* note 34, at 29–30 ("The first [agency problem] involves the conflict between the firm's owners and its hired managers. . . . The problem lies in assuring that the managers are responsive to the owners' interests . . . ."); Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV. 685, 686–87 (2009) (presenting the main debate in corporate law as relating to conflicts between "managers" and "investors"); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 775 (2017) ("The subject of most corporate law scholarship is the conflict of interests between managers . . . and shareholders.").

98. For detailed discussion of conflicts or disparities between shareholders and the corporation, see Raz, *supra* note 1, at 272, 276–78, 282–85, 291 n.145, 293–95, 304–05, 311–19. These issues are addressed in the field of share law, *see infra* Section I.D, which is distinct from corporate fiduciary law, and is based on non-fiduciary equity. A clear example of share law is the law of appraisal: "Directors can satisfy their fiduciary duties even when a sales process is insufficient to achieve the stock's fair value under [DGCL] Section 262." Brief of Law, Economics and Corporate Finance Professors as Amici Curiae in Support of Petitioners-Appellees and Affirmance at 6, DFC Glob. Corp. v. Muirfield Value Partners, L.P.,

holders, or part of them."[99] Both law-and-economists and Delaware jurists, generally mindful of corporate personhood,[100] are likely glossing over this very point when they use inaccurate, practically impossible phrases such as "fiduciary duties to the corporation and its shareholders."[101]

As it turns out, law and economics scholarship itself attaches the highest import to the concept of corporate personhood (despite often not calling it that, instead using terms such as "entity" and "firm," all pointing to the same phenomenon[102]). Hovenkamp,[103] Macey, and Strine[104] provide useful summaries of the major works in this area.

For example, it is one of the greatest law-and-economists of all time, Ronald Coase, who in 1937's *The Nature of the Firm*[105] does not mention the word "shareholder" or "stockholder" even once. Rather, the "firm" is the central actor. It is the firm that decides, based on transaction costs, whether to produce goods and services itself, or outsource certain tasks. The firm as such acts, owns its property, and reaps the gains, or bears the costs, of its activities. The firm is *the opposite* of an aggregate of people contracting with one another, what Coase refers to as the "price mechanism."[106] Clearly, the firm—the corporation—is a distinct legal person. To a large degree, *The Nature of the Firm* is a seminal text about the economic meaning of corporate personhood.

Following a discussion of Coase's article and its relation to modern law and economics, Professor Jason Scott Johnston concludes that "the role of corporate law is both more varied and more creative than either Berle and Means or Easterbrook and Fischel presume, [as it is] a fundamental determinant of strategic bargaining over the terms of the corporate contract."[107] The fundamental, unwaivable *structure* of corporate law

172 A.3d 346 (Del. 2017) (No. 518, 2016), http://www.chancerydaily.com.objects-us-east-1.dream.io/upload/589a4ed825b0e.pdf [https://perma.cc/Z3W2-VVM8].

99. Raz, *supra* note 1, at 260.

100. *See, e.g.*, *supra* notes 49, 68, 70, 74 and accompanying text; *infra* note 220 and accompanying text.

101. *See infra* text accompanying notes 206–07.

102. On the linguistic difficulties plaguing the corporate law community, see *supra* note 4.

103. HERBERT HOVENKAMP, THE OPENING OF AMERICAN LAW 172–83 (2014) (discussing, in a chapter titled "The Separation of Ownership and Control," works by, among others, Berle and Means, Marshall, Coase, Fisher, and Fama and Miller, and explaining how they relate to the differentiation between corporations and their shareholders).

104. Macey & Strine, *supra* note 49, at 463–77 (discussing important law and economics works, mainly within the "nexus of contracts" and "separation of ownership and control" theories, and explaining how they relate to corporate personhood).

105. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

106. *Id. passim.*

107. Jason Scott Johnston, *The Influence of* The Nature of the Firm *on the Theory of Corporate Law*, 18 J. CORP. L. 213, 244 (1993). Johnston makes this observation while discussing constrained rationality, which is one way to examine the central

determines, among other things, the boundaries of "private ordering." In another important conceptual work, Professors Rock and Wachter, expanding on Coase's article, remark that "firms [are] islands of conscious power. These islands [are] surrounded by seas, . . . namely markets."[108] The person bearing that consciousness (with the help of its human representatives)[109] is the corporation.

In modern law and economics, corporate personhood remains as salient. Professors Hansmann and Kraakman, in their well-regarded 2000 article,[110] explore the economic benefits achieved through "asset partitioning"—simply, the fact that the corporation's assets and obligations are its own, not its shareholders' (and vice versa). Asset partitioning allows the corporation and its stakeholders to deal with one another far more cheaply and conveniently, as they need not inquire into each shareholder's financial or legal situation. This economic wizardry is made possible through a specialized *legal* framework—corporate law: "In the absence of organizational law, it would be effectively impossible to create the affirmative asset partitioning that is the core characteristic of a legal entity."[111]

Recently, law and economics scholar Marcel Kahan co-wrote: "What is a corporation, and why does it matter? . . . [H]ow courts characterize the corporation significantly affects legal doctrines that impact not only the corporation, but also *third parties such as shareholders*,"[112] affirming both the importance and the very existence of corporate personhood. In essence, the human-welfare-increasing function of the corporation is channeled through the law of corporate purpose—"the lawful pursuit of profit"—and is not dependent upon the individual, diverging, largely unascertainable, and changing wishes of shareholders.[113]

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phenomenon corporate law is meant to both facilitate and deal with: open-endedness. Due to this, involved actors' rationality, or ability to assess what is going to happen and act accordingly, is inherently constrained, and unique mechanisms (namely, corporate fiduciary law and equity-based share law) are mandatorily required.

108. Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1697 (2001).

109. *See infra* Section I.E.

110. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000).

111. *Id.* at 406. For criticisms of that argument, and a refutation of those criticisms, see *infra* notes 124–30 and accompanying text.

112. Helen Hershkoff & Marcel Kahan, *Forum-Selection Provisions in Corporate "Contracts"*, 93 WASH. L. REV. 265, 266–67 (2018) (emphasis added).

113. *See, e.g.*, Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 159–218 (2019) ("[S]tartups involve heterogeneous shareholders in overlapping governance roles that give rise to vertical and horizontal tensions between founders, investors, executives, and employees. . . . The value of the corporation itself . . . best reflects the sum of the participants' interests and it is to the corporation that the fiduciary duty should be owed."); Leo E. Strine, Jr. & Nicholas Walter, *Originalist or Original: The Difficulties of Reconciling* Citizens United *with Corporate Law History*, 91 NOTRE DAME L. REV. 877, 903 (2016) ("[I]t [is] not credible to equate

The fact that corporations are wholly separate persons, distinct from their shareholders and anyone else, is far from merely an academic issue. It is highly practical, having profound implications at every turn of legal life. Many are discussed throughout this Article,[114] but to give a taste of how numerous the consequences of corporate personhood are, consider the salient example of mandatory arbitration clauses in corporate charters and bylaws.

In recent years, mandatory arbitration has become the most significant barrier for the enforcement of private law rights in the U.S.[115] In essence, the arbitration clause has become the only truly binding part of many consumer and employment contracts.[116] A somewhat different question, however, is what happens when such clauses are inserted into a corporation's constitutional documents. Provisions of this kind would mandate that all corporate law or "internal affairs" disputes (namely, lawsuits against the corporation's fiduciaries, or by shareholders against the corporation) shall be arbitrated, rather than litigated as a direct or derivative action in court. Should they be valid and enforceable? At least presumptively, no.

The reason is that corporate constitutional documents are simply not contracts. Rather, they are equity documents, meant to accomplish a unique feat, possible only through a structured legal framework: the creation of a corporate person, and the pursuit of its purpose through loyal fiduciaries, while meeting its obligations to both stakeholders and residual

the views of the corporation to those of its diverse and changing stockholders."). This point also bears on the "shareholders are stakeholders" argument, *see infra* notes 170–74 and accompanying text.

114. For an additional example, in one case, corporate personhood led to a $246 million greater award of attorneys' fees. *See* Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1252, 1263, 1265 (Del. 2012) (noting that, although 81% of the derivatively-represented corporation's outstanding shares were held by defendant itself, "the corporation was harmed and the total recovery is awarded to the corporation . . . —not 'nominally' but actually," so the $304 million fee award is based on the entire amount of recovery).

115. Boilerplate arbitration clauses, at least in the U.S., usually mean that one party's rights are not truly channeled to alternative dispute resolution, but practically become unenforceable. Among other reasons, that is because non-arbitration methods, such as the class action, are the only effective way to resolve certain disputes, or even have them litigated in the first place. *See, e.g.*, AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 365 (2011) (Breyer, J., dissenting); Arthur R. Miller, *Simplified Pleading, Meaningful Days in Court, and Trials on the Merits: Reflections on the Deformation of Federal Procedure*, 88 N.Y.U. L. REV. 286, 322–31 (2013); Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804 (2015).

116. For a detailed and troubling account of the practice of "deleting" rights (including those presumably granted in the contract itself) through standard form contracts, while asserting that such provisions truly arise from each party's consent, or have the power to completely override other sources of law, see MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW (2013).

claimants. As a series of articles by leading corporate law scholars[117] has recently shown, corporate constitutional documents have, at most, certain contract-like traits, in *some* situations. Primarily, these instruments are meant to deal with the distinctive issues that arise in the corporate environment. Because the corporation itself is party to its constitutional documents,[118] these are not merely agreements between shareholders and managers; instead, they are a mechanism that must serve to promote, rather than obstruct, the reason for the corporation's existence in the first place.[119]

The most pertinent problem, in this regard, is the absolute power and information asymmetries between the corporation and its fiduciaries.[120] For one, fiduciaries can amend the corporation's constitutional documents in a practically one-sided manner (pointing to their non-consent-based, non-contractual nature).[121] Further, given the low observability of fiduciaries' conduct, and the unique, court-based enforcement mechanisms of corporate law (namely, the derivative action), mandatory arbitration would in many cases rob the corporation of any meaningful way to vindicate its rights. It also would eliminate the information-revealing and deterrence-generating effects of litigation in open court.[122] When courts face this issue, they must remain mindful of these fundamental facts—or the enforceability of corporate law's norms, governing some of the most important institutions in our society, would be in existential danger.[123]

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117. James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257 (2015); Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373 (2018); Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583 (2016). Particularly, see Lipton, *supra*, at 587 ("[C]orporate governance arrangements are not contractual. Contract law is organized around a theory of consent . . . . Corporations, by contrast, are organized around principles more akin to trust law . . . .").

118. *See, e.g.*, Macey & Strine, *supra* note 49, at 466 ("[T]he various constituents to the corporation must, of course, have counter-parties. This counterparty is an entity, namely the corporation itself."); Raz, *supra* note 1, at 258 n.4, 272 n.72 (citing statutory and case law demonstrating that the corporation is party to its constitutional documents).

119. On the impossibility of *shareholders* waiving *the corporation's* rights, see Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 722–23 (2011).

120. *See infra* Sections I.E, II.C.

121. *See, e.g.*, sources cited *supra* note 117.

122. *See, e.g.*, Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873 (2019) (exploring the "reputational deterrence" generated by litigation, and not by arbitration, in the information-asymmetrical environment typical of corporate and securities law).

123. In the U.S., this topic is currently in flux. *See, e.g.*, Cydney Posner, *Mandatory Arbitration Shareholder Proposal Goes to Court—As Chair Clayton Suggested*, COOLEY PUBCO (Mar. 25, 2019), https://cooleypubco.com/2019/03/25/mandatory-arbitration-shareholder-proposal-complaint [https://perma.cc/PT2R-CVFV]. The issue in the *Johnson & Johnson* case, discussed *id.*, is the arbitration of federal securities claims, but very similar rationales (i.e., power and information asymmetries precluding actual "consent," and the unique suitability of court-based

Finally, recent scholarship has turned to the topic of alternatives to corporations, including common law trusts,[124] reciprocal insurance exchanges,[125] and security interests.[126] These works confront a basic question: why "corporate law" and not trust law, contract law, or property law, respectively? Why cannot *natural* persons enter into highly complex, multilateral legal relationships, with help from non-corporate law concepts, such as "constructive notice" and "agency?"

The answer is that they can, but it would be so costly and inconvenient that a relationship with an entity—a corporation—is vastly preferable. Each of the frameworks discussed in these articles offer *some* advantages, making them more useful than corporate law in *some* situations. Yet, neither trusts, nor reciprocal contracts, nor security interests offer *all* the benefits of a corporation, or do so in the *very wide, flexible range of situations* which the corporation is fit to address.

For example, Verstein's discussion of reciprocal insurance makes clear that such arrangements are highly *repetitive*: the "attorney-in-fact"—the natural person who signs new contracts, receives premium payments, and distributes insurance benefits to a large number of subscribers[127]—basically does that, and not much else. The attorney-in-fact is bound by the terms of the contracts with each insured party. These are insurance, not trade, manufacturing, or anything-else contracts. Attorneys-in-fact cannot, in their role as such, enter into new activities, as they have far less than the general, unlimited legal capacity of a corporation. The same is true of *any* contract: the agreement has some *terms* and *boundaries*; it does not say "do whatever you wish."[128]

Yet, one type of legal instrument—corporations' constitutional documents—says precisely that, and is predicated on the corporation's general capacity to act as a person. Put simply, can anyone imagine Google oper-

procedures for resolving corporate law disputes) apply in regard to internal affairs, state law claims.

124. *See* John Morley, *The Common Law Corporation: The Power of the Trust in Anglo-American Business History*, 116 COLUM. L. REV. 2145 (2016).

125. *See* Andrew Verstein, *Enterprise Without Entities*, 116 MICH. L. REV. 247 (2017).

126. *See* Ofer Eldar & Andrew Verstein, *The Enduring Distinction Between Business Entities and Security Interests*, 92 S. CAL. L. REV. 213 (2019).

127. For a description of reciprocal insurance exchanges' basic structure, see Verstein, *supra* note 125, at 264–66.

128. *See, e.g.*, Cox, *supra* note 117, at 279 n.91 ("[T]he requirement of definiteness is not a matter that the parties can waive if they are to have a contract. Indeed, it is tautological to argue that the parties can agree to an indefinite level of performance, since there cannot be an agreement if parties do not know to what they have agreed."). Some contracts might seem to be saying something similar to "do whatever you wish"—for example, a lawyer's retainer agreement or a physician's medical care agreement—but even they are constrained by certain positive law frameworks: legal ethics and medical ethics, respectively, along with general fiduciary law. In contrast, the corporation is not necessarily anyone's fiduciary; it is constrained only by corporate law's imperative to pursue its purpose.

ating not as a corporate entity, but as a web of reciprocal contracts among *billions* of consumers, employees, managers and others? Quite clearly not. The existence of a central party, having its own rights, duties, identity and traits, and surviving the death (or other disability, or just change of mind) of any natural person, enables something special to happen. Google, like most corporations, engages in a host of dynamic acts and relationships, undefined—and to a large extent, *unimaginable*—by anyone in advance. This can only be achieved through corporate law, with its concept of personhood and its open-ended, equity-based dictates.[129]

It is no surprise, then, that Eldar and Verstein describe business entities as "enduring" in their article title, and conclude, "the species of entity . . . will survive long after [other categories in private law have] dissolved."[130]

C. *The Corporation's Stakeholders*

Theoretically, it is possible for a corporation not to have non-residual claimants (in this Article referred to as "stakeholders"[131]). A corporation might be established, with its shareholders conveying to it some property; beyond that, the corporation would engage in no other contract or relationship. However, such a scenario, if it occurs at all, is exceedingly rare. Practically, almost every corporation has stakeholders. Corporations are usually meant to carry out activities more complex than individuals can effectively achieve; in turn, this gives rise to relationships with various stakeholders, such as employees, consumers, financial creditors, and many others. Therefore, a complete theory of corporate law should have some-

129. Even the common law of trusts, *see* Morley, *supra* note 124, while grounded in equity, offers less than corporate law's combination of flexibility and certainty. For instance, "[t]rust law had always allowed a trust to persist after the death, disappearance, or change of a beneficiary," *id.* at 2194, but what about the death or disappearance of a *trustee*? Even if trust law did try to resolve these various conundrums, the litigation and uncertainty costs surrounding them would be much higher than those afforded by the widespread understanding of the corporation's nature as a separate and enduring person. Furthermore, trust law does not provide the same open-ended, "any lawful act or activity" imperative as corporate law, *see supra* note 22. Instead, a trust relationship has an ex ante information "anchor" in the form of trust property, for the loss of which the trustee is subject to legal sanction. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS §§ 2 cmt. i (AM. LAW INST. 2003) ("A trust cannot be created unless there is trust property in existence . . . ."), 5 cmt. a(2) ("In any event, and often crucial in determining the character of a relationship, there can be no trust without identifiable trust property."), 100 ("A trustee who commits a breach of trust is chargeable with . . . the amount required to restore the values of the trust estate . . . or . . . the amount of any benefit to the trustee personally as a result of the breach."). Consequently, trust law cannot facilitate the same range of unpredictable adventures as corporate law. The trustee's actions are more constrained before-the-fact, compared to those of a corporation; as a result, corporate law generates a much wider potential for both risk and reward.

130. Eldar & Verstein, *supra* note 126, at 269.

131. *See supra* note 23.

thing to say about stakeholders: what kind of rights and duties do they have? Which areas of law provide the tools to resolve the questions pertaining to them?

As is typical in the present-day dichotomy of corporate law, shareholderists and stakeholderists have different answers. To start with, many shareholderists follow a mode of thinking, quite common in the U.S., which can be summarized as: "If it's not happening in the headlines, it's not happening."[132] Accordingly, they concentrate on one term—"contract"—to describe the innumerably diverse set of relationships a corporation might have with its stakeholders. For example, in a 2009 article, Judge Easterbrook broadly posits that "[i]n all of this there are no third-party effects. Competition and contracts promote efficiency . . . . Strangers to the finance and governance bargain, such as debt investors and labor, arrange their affairs by their own contracts. . . . [F]ree contracting in a competitive system just has to promote everyone's welfare."[133] This sort of "headline" writing ignores the wide array of frameworks that comprise positive law (such as employment law, torts, environmental law, trusts, fiduciary law, unjust enrichment, general equity, and so on, alongside contract law), which binds every person, including corporations, and which often has very little to do with "contract," or any ex ante, bargained-for set of choices.

In reality, there *are* "third-party effects," power and information asymmetries, and need for equity and nuance. An employment relationship is different than that between lender and borrower in the LIBOR market.[134] The law pierces many veils; yet, we can never pierce law itself. Thus, a more accurate choice of words than "contract" would be "positive law." By definition, no one is allowed to commit an unlawful act.[135] Equally, it is

132. Chris William Sanchirico, *Win or Lose on Amazon, Philly Needs to Get Smart About Attracting New Businesses*, PHILA. INQUIRER (Oct. 25, 2017), https://www.inquirer.com/philly/opinion/commentary/amazon-hq2-philadelphia-business-kenney-20171025.html [https://perma.cc/PGV9-YJGG].

133. Easterbrook, *supra* note 97, at 690.

134. Indeed, employment relationships generally form a large part of people's lives and identity, and give rise to many troubling issues. *See, e.g.*, Milja Milenkovic, *42 Worrying Workplace Stress Statistics*, AM. INST. OF STRESS (Sept. 23, 2019), https://www.stress.org/42-worrying-workplace-stress-statistics [https://perma.cc/9W3Z-Q5FE] (citing studies showing, among other things, that "[o]ver a third of people said their job was a regular source of stress in 2018," and that this stress can often be attributed to specific, employer-dependent causes, such as "poor communication practices by . . . employers" and "a heavy workload").

135. *See, e.g.*, Sean J. Griffith, *Agency, Authority, and Compliance*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE (D. Daniel Sokol & Benjamin van Rooij eds., forthcoming 2021) (manuscript at 2), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3462638 [https://perma.cc/QM8X-GM3H] ("Law is what you must do—the rules and regulations originating from the sovereign, transgression of which may lead to deprivation of property or, in some cases, liberty."). Additionally, within corporate law, many cases establish that a corporation is never permitted to act unlawfully (even to achieve profit), and its fiduciaries violate their duties if they cause it to do so. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698

not possible to impose a legal sanction for a lawful act. Law is imperfect, but it can be reformed—which requires going through the democratic, judicial, or regulatory process, and cannot consist of someone subjectively "declaring" that a certain behavior is right or wrong.[136] It is not always easy to ascertain what positive law says, but it does say *something*, and does not say *anything* anyone might wish for.[137]

Furthermore, the corporation's relationships with its stakeholders are such that a natural person might also enter (albeit often on a different scale). Both a corporation and a human can borrow money, have employees, or purchase goods and services. As a result, it is *general, non-corporate law* that provides the vast majority of norms governing corporations (and anyone else). The corporation's obligations toward its employees or financial creditors are external to corporate law. Legal or contractual changes to those relationships do not modify corporate law. Rather, those obligations are subsumed, as a whole, into the definitional requirement that the corporation act lawfully. Anything that happens *within* corporate law—including the rights of residual claimants—happens only after that requirement is satisfied.[138]

This fact—that non-corporate law regulates the corporation's relationships with its stakeholders—has been firmly established in U.S. law since at least 1877, when the Supreme Court decided *Munn v. Illinois.*[139] There, an "unincorporated" company (a corporation[140] not "chartered" by the state) challenged a price regulation on the grounds that, lacking a state-issued charter, the state has no power to tell the company how to run an aspect of its business. Rejecting this argument, Chief Justice Waite found that *any* business "affected with a public interest"[141] may be publicly regulated. In other words, regulation of corporations' effect on the public

A.2d 959 (Del. Ch. 1996) (foundational Delaware case on the issue); Marchand v. Barnhill, 212 A.3d 805 (Del. 2019); *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222-JRS, 2019 Del. Ch. LEXIS 1293 (Del. Ch. Oct. 1, 2019); *In re* Massey Energy Co. Derivative & Class Action Litig., No. 5430-VCS, 2011 Del. Ch. LEXIS 83, at *73–74 (Del. Ch. May 31, 2011) ("Delaware law allows corporations to pursue diverse means to make a profit, subject to a critical statutory floor, which is the requirement that Delaware corporations only pursue 'lawful business' by 'lawful acts.' As a result, a fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law." (footnote omitted)); Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2017 (2019) ("Delaware courts have prioritized giving directors broad latitude to take business risk by *drawing a line at legal risk* . . . ." (emphasis added)).

136. *See, e.g.*, Strine, *supra* note 8, at 790.

137. *See supra* note 24 (discussing the meaning of positive law).

138. *See* Raz, *supra* note 1, at 275–76 ("[T]he residual interests . . . [are] those left after all corporate obligations, of any kind, to all non-residual claimants are satisfied, in practice or in capacity."); *see also id.* at 274 n.77 (explaining how both corporate and non-corporate law operationalize this ever-present requirement).

139. 94 U.S. 113 (1877).

140. On the broad meaning of "corporation" as used in this Article, see *supra* note 1.

141. *Munn*, 94 U.S. at 130.

is not within the realm of corporate law; it does not flow from the corporation's constitutional documents. Rather, it is part of general law, which applies to both corporations and natural persons.[142]

More recently, a leading figure of global corporate law went on to express the same idea: according to Chief Justice Strine, "[a] corporate law case is not a case about all laws, but about a law. We are not environment protection law, labor law or antitrust law—you stay in your lane."[143] Strine advocates the same theme in a long series of scholarly articles,[144] making clear that protecting stakeholders against externalities, while certainly lacking in the U.S. and around the world, is not part of *corporate* law. Strine specifically concludes that "if interests such as the environment, workers, and consumers are to be protected, then what is required is a revival of effective externality regulation that gives these interests more effective and timely protection,"[145] contrasting "externality regulation" with norms "within corporation law itself."[146] Other scholars have made this point in various contexts,[147] and a recent article by Professor Mariana Pargendler "raises the possibility that the promise of corporate governance may have been overrated, . . . [as it] may crowd out potentially more effective responses to the problems at hand."[148]

The *inherent* difference, in structural terms, between corporate and non-corporate law is the result of at least two factors. First, corporate law involves different *actors*. The terms "corporation," "shareholder," and "director" result exclusively from the corporate framework. There can be no

142. *See* Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1628–32 (1988) (discussing *Munn* and the other *Granger* cases; noting that "*Munn* had been selected for a full opinion on state power to regulate prices because the company was unincorporated," that the Court in these cases "[upheld] rate regulation of natural persons provided the regulated *market* was 'affected with the public interest,'" and that "*Munn* . . . made corporate status irrelevant to the states' power to regulate rates").

143. Rita K. Farrell, *At Top of Delaware Chancery Court, Adherence to Tradition*, N.Y. TIMES (July 6, 2011), https://dealbook.nytimes.com/2011/07/06/at-top-of-delaware-chancery-court-adherence-to-tradition [https://perma.cc/7V5Z-4TT7] (interviewing then-Chancellor Strine).

144. *See, e.g.*, Leo E. Strine, Jr, *Corporate Power is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. ECON. POL'Y 176, 177 (2017) [hereinafter Strine, *Corporate Power is Corporate Purpose*]; Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 145–46, 171–72 (2012); Strine, *supra* note 8, at 768, 786–93.

145. Strine, *supra* note 8, at 793.

146. *Id.* at 768.

147. *See, e.g.*, Tamar Frankel, *The Delaware Business Trust Act Failure as the New Corporate Law*, 23 CARDOZO L. REV. 325, 328 (2001) ("Laws offering models for business organizations . . . cover *relationships between the interested parties within the organizations* . . . . None of these laws, however, regulates the *businesses in which the organizations engage*. Those . . . businesses are regulated by other laws, unrelated to [their] organizational structures . . . ."); Larry E. Ribstein, *The Important Role of Non-Organization Law*, 40 WAKE FOREST L. REV. 751 (2005).

148. Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 402 (2016).

director for a natural person; and, while a natural person does in some sense have "residual claimants"—the person's presumptive heirs[149]—they have no legal standing during the person's life, in terms of setting a purpose, appointing fiduciaries, or any of the rights granted to shareholders. Thus, special norms[150] are required to regulate the relationships generated by the corporate framework, but not other relationships, which equally attach to natural and corporate persons.

Second, corporate law differs from non-corporate law in the *information content* of the legal norms. Every legal field provides some set of imperatives. The command might be detailed ("pay $100 to the bondholder on July 1") or undetailed ("act equitably with the trust property"), but it exists. Corporate law, in contrast, provides the most undetailed guidance of all: it simply tells the corporation to "do whatever." A corporation can literally act however it wishes, subject to only one imperative: "lawfully pursue profit" (or any other purpose, depending on the type of corporation).[151] Among other issues, this makes corporate law entirely unsuitable to govern the substantive rights and duties of anyone other than the actors affected by the open-ended part ("pursue profit")—that is, the corporation, its residual claimants, and its fiduciaries—as opposed to those affected by the close-ended part ("lawfully"), that is, stakeholders.

Crucially, attempting to set stakeholders' rights within corporate law would actually place stakeholders in an *inferior* position, compared to what they have today. That is because non-corporate law, with its more specific and information-rich content, provides both better rights and better enforcement. Legal actors need information to know (and act on) their rights and duties. Trying to enforce stakeholders' rights within corporate law would generate an extreme information asymmetry, between the *wished-for*, subjective demands—nowhere found in positive law—of various stakeholders, and what the corporation can *know* it is obliged to do, ascertainable through law.[152] This asymmetry is absolute and inevitable. Even

149. *See* Raz, *supra* note 1, at 274–75.

150. Moreover, special mechanisms are required to *enforce* those norms, such as the derivative action, which is a unique creature of corporate law. The distinction between derivative and direct actions has far-reaching implications. *See, e.g.*, *id.* at 295 n.159.

151. *See supra* Section I.A; *supra* note 22. This point is embodied in the fact that the corporation's goals might be "to engage in any lawful act or activity." DEL. CODE ANN. tit. 8, § 102(a)(3) (2020).

152. The same holds true if the "do whatever (in the lawful pursuit of profit)" imperative is augmented with seemingly more specific language, which actually does nothing to resolve the asymmetry described here. One example is saying that the corporation must promote "general public benefit." Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018). By design, *law* cannot provide any guide or imperative to operationalize this abstract requirement. Imposing such a "duty" assumes law away, replacing it with after-the-fact, subjective determination of whether the corporation acted "right" or "wrong." Among other issues, this kind of legislation might violate the constitutional vagueness doctrine. *See, e.g.*, Eugene Volokh, *The Void for Vagueness / Fair Notice Doctrine and Civil Cases*, VOLOKH CONSPIRACY (June 21, 2012, 12:19 PM), http://volokh.com/2012/06/21/the-void-for-

if the corporation could somehow read stakeholders' minds, there would still be no logical way to say that the lawful is unlawful. The *only* way to align the corporation's duties with stakeholders' interests, in a legally enforceable way, is to change the law. That happens all the time, in legislatures, courts, regulatory agencies, and private agreements. Still, if existing law sets the minimum wage at *x*, it simply is not *2x*, or *0.5x*, unless the law is changed. Working to improve non-corporate law would be more fruitful in both achieving desired societal goals, and not disturbing the equity-based structure of corporate law.

Accordingly, statements that corporate law should promote "the aggregate welfare of all who are affected by a firm's activities,"[153] "overall social welfare,"[154] or "cooperative economic activity"[155] must be understood in context. They are not a recipe for arbitrariness. Promotion of social welfare does not entail creating "rights" (at cost to others) out of whole cloth. Rather, it means maximizing involved actors' welfare, so that claims are initially allocated in a just and efficient manner, and each of the actors then receive their full legal claim.

Consistent with the purpose-based structure of corporate law, it is also true that stakeholders' interests, beyond their current positive law claims, may be considered by the corporation, to the extent such consideration advances the corporation's purpose. Among other cases,[156] *Paramount v. Time* provides a perfect example. Time's "journalistic integrity"[157] is a value it voluntarily adopted, under no legal obligation to do so. None of Time's stakeholders have a legal claim to the preservation of "Time Culture."[158] Non-corporate law, including the First Amendment,[159] permits

vagueness-fair-notice-doctrine-and-civil-cases [https://perma.cc/2AQ5-PXRQ] (surveying case law applying the constitutional vagueness doctrine in administrative law and other civil contexts; noting that the doctrine "is applicable to cases that involve civil penalties and not just criminal liability").

153. KRAAKMAN ET AL., *supra* note 34, at 22.

154. *Id.* at 23.

155. WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 343 (5th ed. 2016). For a similar statement, see William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713, 714 (2014) ("[B]usiness corporations exist to create wealth . . . ."). To complete this kind of argument, one should ask: *whose* wealth does a corporation create? The corporation's (similar to natural persons, entitled to the fruit of their efforts, subject to meeting all legal obligations). How do we know what legal claims other people have toward the corporation? Through law.

156. *See, e.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (refusing to interfere in a corporation's decision not to install lights in a stadium, an expansion which allegedly would have led to higher revenue from nighttime games; reasoning that the decision, which considered "the effect on the surrounding neighborhood," might promote the "long run [economic] interest" of the corporation).

157. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1144 (Del. 1989).

158. *Id. passim.*

159. U.S. CONST. amend. I.

anyone to engage in publishing that lacks integrity.[160] Yet, in the face of a hostile takeover attempt, Time was allowed to defend this value, *because it promoted the corporation's purpose*—the lawful pursuit of profit.[161]

The legal response to an extremely significant national crisis—the opioid epidemic—provides a perfect illustration of the framework discussed here. In December 2018, the United States District Court for the Northern District of Ohio denied pharmaceutical defendants' motions to dismiss the consolidated civil action filed against them.[162] As the decision shows, the defendants are *the pharmaceutical corporations* themselves, as separate legal persons—not their shareholders, employees, or fiduciaries.[163] It is the corporation, having the same capacity as a natural person, that dealt with the victims, and should pay for their injuries. Furthermore, none of the causes of action have anything to do with corporate law: the plaintiffs seek remedies arising in such areas as tort law and unjust enrichment; they were injured not as a corporation or shareholders, but as patients, consumers, family members, and public service providers. If a natural person committed the same acts the corporations are being sued for, the case would look no different.

Moreover, if we somehow tried to apply corporate law in this case, it would provide "null results": nothing within corporate law tells the pharmaceutical corporations whether their opioid marketing practices are legally permissible. Attempting to rely on corporate law, or even a more "socialized" version thereof, would yield *worse* outcomes for the victims: the corporations could simply claim that they acted in furtherance of "general public benefit,"[164] and any court proceeding would focus on interpreting that ambiguous phrase, rather than utilize the much more specific, information-rich tools of tort law and the other causes of action, developed over centuries of jurisprudence.

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160. Again, within the bounds of positive law. Defamation, for example, is prohibited. Yet, there are many kinds of lawful publishing that lack integrity—see your closest tabloid.

161. *See Paramount v. Time*, 571 A.2d at 1150 ("[Directors'] broad mandate includes a conferred authority to set a corporate course of action . . . designed to enhance corporate profitability."); Paramount Commc'ns, Inc. v. Time Inc., Nos. 10866, 10670, 10935 (Consol.), 1989 Del. Ch. LEXIS 77, at *22–86 (Del. Ch. July 14, 1989) ("[T]here is insufficient basis to suppose at this juncture that such concerns [for the 'Time culture'] have caused the directors to sacrifice or ignore their duty to seek to maximize in the long run financial returns to the corporation . . . . [W]here the board . . . continues to manage the corporation for long-term profit . . . , the corporation has a legally cognizable interest in achieving that plan."), *aff'd*, 571 A.2d 1140 (Del. 1989).

162. County of Summit v. Purdue Pharma L.P. (*In re* Nat'l Prescription Opiate Litig.), No. 1:17-md-2804, 2018 U.S. Dist. LEXIS 213657 (N.D. Ohio Dec. 19, 2018).

163. *See id.* at *1–55 (listing the parties in the case; indicating that the vast majority of defendants are corporations, while the few natural persons listed as defendants are, according to a separate web search, physicians and pharmacists, not related to a corporate defendant).

164. Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018).

Despite all this, many stakeholderists do not believe that a corporation meeting all of its legal obligations has done enough; they argue it should still potentially be subject to legal sanction. Aiming to somehow import stakeholders' claims into *corporate* law, they wish to transform the corporation's purpose from the lawful pursuit of its own benefit to an altruistic endeavor. The final paragraphs of this Section consider several important arguments to that effect.

At the outset, we sometimes encounter foggy metaphors, such as referring to stakeholders as if they are "constituent parts" of the corporation.[165] Such physiological allusions are without merit, since the corporation is a person—one entity, not "composed" of anyone else.[166] Corporations are no more made up of shareholders and stakeholders than natural persons are composed of the bank that holds their account and the college to which they pay tuition. Moreover, placing the corporation's *fiduciaries* in the center, and expecting them to divide their loyalties among multiple stakeholders, shifts the focus away from where it is due: the corporation itself, which is the beneficiary of its fiduciaries' duties, and the person serving as stakeholders' counterparty. As has been correctly argued,[167] such pluralization of fiduciaries' duties only amounts to a grant of unchecked power to fiduciaries, while producing little, or negative, benefits for both the corporation, stakeholders, and shareholders. In reality, as described in this Section, what corporations have with their stakeholders is an array of *legal relationships*, governed by *legal norms*.

Even when recognizing this, stakeholderists often fail to locate the correct sphere in which to pursue desirable reforms: non-corporate law. Rather, they call for ambiguous "corporate social responsibility" (CSR), overlooking the central questions: how does the corporation—or anyone else—objectively *know* what is socially responsible? Even assuming that "socially responsible" represents some better standard of conduct than

165. *See, e.g.*, ALLEN & KRAAKMAN, *supra* note 155, at 284 ("To whom do directors owe loyalty? The short answer is that they owe their duty to the corporation as a legal entity. Yet . . . [t]he 'corporation' has multiple constituencies with conflicting interests, including stockholders, creditors, employees, suppliers, and customers. To say that directors owe loyalty to the corporation masks conflicts among these constituencies." (footnote omitted)). However, that is not the "short" answer but the accurate one; the corporation should not be placed in quote marks; stakeholders do not "constitute" the corporation, but exist separately from it and from one another; and their mutual conflicts (or, more commonly, their conflicts with the corporation) should be resolved according to law (as opposed to directors' guesswork), just like other disputes among people.

166. *See, e.g.*, Raz, *supra* note 1, at 285–87 (explaining why "aggregate" theories of the corporation are incorrect); *supra* Section I.B.

167. *See, e.g.*, *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 42 n.16 (Del. Ch. 2013) ("[A] multivariate fiduciary calculus quickly devolves into the equitable equivalent of a constituency statute with a concomitant decline in accountability."); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991) ("[A] manager told to serve two masters . . . has been freed of both and is answerable to neither.").

"lawful," how can *legal* institutions enforce that standard, when *by definition*, no legal sanction can be imposed for lawful behavior?

Recent scholarship[168] has gone so far as to *condemn* governments for doing precisely the right thing: regulating corporations through stronger, clearer statements of positive law. Instead, that article mysteriously demands an overriding reliance on "CSR."[169] Proposals of this kind effectively seek to turn corporations and their fiduciaries into omnipotent private lawmakers, arbitrarily creating and enforcing their own rules as to what is "responsible." The concept of law does not work this way.

Another line of argument is that, in essence, shareholders *are* stakeholders. Greenwood,[170] Hart and Zingales,[171] and Strine,[172] to cite three leading examples, correctly note that shareholders, in addition to the relationship they have with the corporation under share law, might often be employees, consumers, or people otherwise affected by corporate actions. Presumably, even under a "shareholder-oriented" view, corporate law should therefore tend to the stakeholderist side.

This argument, however, looks under the wrong lamppost. To begin with, as this Article proves extensively, corporate law is not, cannot, and should not be about shareholder primacy; rather, the corporation—separate from its shareholders, and not meant to serve any of them individually[173]—is at the heart of corporate law, which aims to facilitate the pursuit of the corporation's own purpose.

Second, and more fundamentally, people engage in a variety of *different* relationships with one another. A dentist might also be a psychologist, but a patient coming for a root canal does not expect marriage advice, and vice versa. Even if some patient did receive both treatments, each is governed by a separate contract or legal framework, and requires the doctor to engage in a separate decision-making process (and, hopefully, not perform both at the same time). Similarly, a shareholder might also be an

168. Gerlinde Berger-Walliser & Inara Scott, *Redefining Corporate Social Responsibility in an Era of Globalization and Regulatory Hardening*, 55 AM. BUS. L.J. 167 (2018).

169. *Id. passim.*

170. Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996).

171. Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017).

172. Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017).

173. This is important in the context of the "shareholders are stakeholders" argument, since different shareholders have diverging interests, both as shareholders and, certainly, as stakeholders. One shareholder is an employee, but another is not. Even two shareholder-employees might experience different outcomes from the same corporate action. The fine-grained treatment offered by separate fields—corporate law and non-corporate employment law—is far more capable of handling the fine-grained distinctions between different people in varying situations.

employee and a consumer, but these are three distinct relationships, each handled within a different toolbox, or set of legal norms (corporate law, employment law and consumer protection law). In fact, because shares are *residual* claims, that shareholder is *first and foremost* an employee and a consumer. The corporation must meet all of its obligations under non-corporate law before the shareholder as such can see any benefit. Thus, the "shareholders are stakeholders" argument does not add much to the *corporate* law debate, since stakeholders are already as protected as possible under non-corporate law.[174]

In summary, stakeholderists raise many valid arguments regarding the shortcomings of existing law. Very often, the protections afforded to employees, consumers, lenders, or the environment might be suboptimal. Within the legal sphere, there is one way to deal with that: going through the *legal* process to refine positive, binding law. We ought to fix the law where such reforms would be effective; we should not throw simplistic statements into a toolbox incapable of handling them,[175] hoping that corporate directors (of all people)[176] would somehow save the day. As Professor Kent Greenfield observes, "corporations are people too (and they should act like it)."[177] This also means that no extra-legal, subjective "norms," conveyed in whichever three-letter acronym favored by a given commentator,[178] somehow bind corporations and not others. The correct three letters are "law."

D. *The Corporation's Residual Claimants*

Every corporation, at any given moment, has at least one residual claimant. As a previous article explains, "[t]he underlying reason for this is that a corporation's life can end . . . . When that happens, the corporation's interests . . . do not disappear. . . . [O]nly rarely, if ever, do a corporation's interests precisely equal its liabilities. . . . [The] person entitled to receive the difference, or 'residual[,]' . . . is the residual claimant."[179] Ad-

174. *See supra* text accompanying notes 151–52.

175. *See, e.g.*, Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018) (requiring that corporations act to further "general public benefit").

176. *See* Strine, *Corporate Power is Corporate Purpose*, *supra* note 144, at 177 ("Pretending that corporate boards—an odd recourse for ordinary people anyway—are to be looked at as a source of protection and solace for workers, the environment, and consumers dilutes the focus that is actually needed, which is on the protections from externalities that other constituencies deserve.").

177. KENT GREENFIELD, CORPORATIONS ARE PEOPLE TOO (AND THEY SHOULD ACT LIKE IT) (2018).

178. *See, e.g.*, Martin Lipton, *Corporate Purpose: ESG, CSR, PRI and Sustainable Long-Term Investment*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 4, 2018), https://corpgov.law.harvard.edu/2018/05/04/corporate-purpose-esg-csr-pri-and-sustainable-long-term-investment [https://perma.cc/RFC7-YSNM].

179. Raz, *supra* note 1, at 272–73. As a result, even nonprofit corporations have residual claimants. The question "who would be entitled to receive the corporation's residual?" might sometimes be decided ex post (in the case of nonprofit corporations, this would usually entail dedicating the residual to similar goals as

ditionally, residual claimants play a crucial role at the opposite end of the corporation's life cycle: by default, they are the people who *establish* the corporation, providing corporate law with entities to govern in the first place.[180] The question, then, is what *is* a residual claim? What kind of rights does a shareholder (or "member," or "partner") have, toward whom, and governed by which legal framework?

A well-liked children's toy consists of a box with an internal array of mirrors, into which coins can be inserted. When the user opens the top of the box, the coin is nowhere to be found. Only by following a certain process, which requires accessing a hidden compartment, can the user retrieve the economic value stored in the box. The structure of corporate law places shareholders in a similar position. The coin (shareholders' equitable claim) always exists, but so does the box (the corporation). Only by going through the process (corporate law, and none else) may the shareholder see any benefit.

What makes shares and shareholders' rights so special is that they cannot be explained by any legal framework *other* than corporate law; and even within corporate law, nuances apply. Allen and Kraakman put it simply: "[Shareholders] have no right to any periodic payment, nor can they demand the return of their investment from the corporation. Nor . . . can they typically tell the firm's managers what to do."[181] Thus, neither contract law nor agency law govern shares. From many additional aspects, shareholders are not mere contractual parties.[182] Other common "metaphors" are also misguided: as this Article demonstrates, the corporation is an unownable person; and the corporation—not shareholders—is the owner of its property. Shareholders only own their shares (which are bundles of rights *toward*, not "in" the corporation); the "property" or "investor ownership" metaphors are empty vessels.[183] Furthermore, shareholders are not trust beneficiaries,[184] or (the view most common in the U.S.) direct beneficiaries of the corporation's directors and officers under fiduciary law.[185] As a rule, fiduciaries' duties run to the corporate person, not to shareholders (or anyone else). Moreover, the corporation's interests might diverge from those of shareholders, or part of them.[186] Thus, even within corporate law, share law is distinct from corporate fiduciary law. The former deals primarily with the corporation's obligations to shareholders, and the latter—with fiduciaries' obligations to the corporation.

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those of the dissolving corporation), but in any case, *some* person would receive the residual assets.

180. *See id.* at 273.

181. ALLEN & KRAAKMAN, *supra* note 155, at 143.

182. *See* Raz, *supra* note 1, at 282–85.

183. *See id.* at 285–87.

184. *See id.* at 287–90.

185. *See id.* at 290–301.

186. *See supra* note 98 and accompanying text.

As a result, the law of shares is not founded on concepts of contract, agency, property, trust, or fiduciary law. Rather, the basis of shareholders' rights—quite simply, the answer to the question "why do shares have value?"—resides in a concept of equity.[187] The various "agency problems" between the corporation and its shareholders are resolved with equitable (but mostly non-fiduciary) tools, such as the law of share dilution, dividends and buybacks, appraisal rights, shareholder voting, books and records inspection, shareholder litigation, and other mechanisms.[188]

Nuance is key here: shareholders have lesser standing than fiduciary law principals, and do not own the corporation or its property. Yet, this does not mean they are "merely owners of . . . certain contractual claims."[189] The residual nature of shares makes them *anything but* certain.[190] Shareholders' "contract" with the corporation (its constitutional documents) might, at most, *resemble* a contract, for specific purposes and in *some* cases. In fact, corporate charters and bylaws can better be described as equity documents. They rely on unwaivable legal and equitable constructs, meant to respond to the problems generated by corporate law's power- and information-asymmetric nature.[191]

Importantly, the non-fiduciary nature of shareholders' rights has an exception. Most of the time, whatever effect fiduciaries have on shareholders is channeled through the corporation. Yet, in *some* situations, shareholders might gain a direct claim toward the corporation's fiduciaries. This exception only occurs in "a limited set of circumstances,"[192] when the channeling principle is violated, and the fiduciary action at issue does not materially affect the corporation itself. That happens, for example, in *Revlon* mode,[193] when fiduciaries directly control the fate of shareholders' investment, while the corporation, nearing a "breakup,"[194] has

187. *See* Raz, *supra* note 1, at 302–11. Note that fiduciary law and equity are not the same. Fiduciary law is one branch of equity. A person (such as a shareholder) can have equitable rights, while not being owed fiduciary duties. *See id.* at 294–95, 303–05; *supra* note 98. For a detailed illustration of equity as a distinct concept from fiduciary law, and share law as grounded in non-fiduciary equity, see Paul B. Miller, *Equity, Majoritarian Governance, and the Oppression Remedy*, *in* FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur B. Laby & Jacob Hale Russell eds., forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3483563 [https://perma.cc/5FB9-HW94].

188. *See* Raz, *supra* note 1, at 311–19.

189. Macey & Strine, *supra* note 49, at 483.

190. *See* Raz, *supra* note 1, at 276–78, 282–85, 308–09.

191. *See supra* text accompanying notes 117–23.

192. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989).

193. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[Once the company was for sale,] [t]he duty of the board had . . . changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role[, before the company was for sale, was to serve as] defenders of the corporate bastion . . . .").

194. *Paramount v. Time*, 571 A.2d at 1150.

no skin in the game. Other violations of the channeling principle can occur.[195] Again, these are special cases—particularly considering that most corporations, most of the time, are a "going concern," not in *Revlon* mode, and not at the end of their lives.

Today, both shareholderists and stakeholderists tend to characterize *all* corporate law in terms of fiduciary duties (to shareholders or others), thus overlooking either the corporation's personhood, or the principles of fiduciary law, which require "single-minded" dedication to the beneficiary (the corporation).[196] The mischaracterization of all corporate law as fiduciary law, and of shareholders as fiduciary law beneficiaries, generates subtle faults with many practical consequences. For example, while discussing the case of *Smith v. Atlantic Properties, Inc.*,[197] Professor Mark Ramseyer comments that "[t]he opinion makes no sense . . . . If the one [shareholder] owed the three [other shareholders] a fiduciary duty, the three owed the one the same."[198] In fact, the opinion makes a lot of sense, once we recognize that neither shareholder owed the others a "fiduciary" duty; rather, as controlling shareholders, they owed their duties to the corporation.[199] Despite using less-than-optimal language, the court correctly held the one dissenting shareholder, who prevented a distribution and thereby caused the corporation to pay higher taxes, to have breached his fiduciary obligations.

On the flip side, a more recent Massachusetts case illustrates the grave outcomes a misreading of corporate law's structure and nuances can bring for shareholders as such. Initially, 2017's *International Brotherhood of Electrical Workers Local No. 129 Benefit Fund v. Tucci*[200] decision seems to cohere with the framework presented in this Article: as the court says, "the general rule of Massachusetts corporate law is that a director of a Massachusetts corporation owes a fiduciary duty to the corporation itself, and not its shareholders."[201] So far, so good, but in this case, the exception discussed above applies; a channeling principle issue arose. The facts in this case are akin to *Revlon* mode: the question was whether directors acted to maximize the value of *shareholders'* shares—not *the corporation's* assets—when

195. *See* Raz, *supra* note 1, at 299 n.168.

196. *See, e.g.*, Birnbaum v. Birnbaum, 539 N.E.2d 574, 576 (N.Y. 1989) ("[I]t is elemental that a fiduciary owes a duty of undivided and undiluted loyalty to those whose interests the fiduciary is to protect. . . . [A] fiduciary . . . is bound to single-mindedly pursue the interests of those to whom a duty of loyalty is owed . . . ." (citation omitted)); Bristol & W. Bldg. Soc'y v. Mothew [1996] EWCA (Civ) 533, [1998] Ch 1, 18 (appeal taken from Eng.) (a globally cited case on fiduciary law principles, stating that "[t]he principal is entitled to the single-minded loyalty of his fiduciary").

197. 422 N.E.2d 798 (Mass. App. Ct. 1981).

198. J. Mark Ramseyer, *Introduction*, *in* CORPORATE LAW STORIES 1, 1 (J. Mark Ramseyer ed., 2009).

199. *See, e.g.*, Raz, *supra* note 1, at 297 n.164; *infra* Section II.A.

200. 70 N.E.3d 918 (Mass. 2017).

201. *Id.* at 926.

they carried out a merger that forfeited those shares from their owners. In this scenario, as Delaware law correctly and equitably recognizes, directors become ad hoc fiduciaries for shareholders.

The *Tucci* court, however, chose to forego a substantive, structural (and economic) inquiry of corporate law, instead formalistically focusing on two exceptions found in case law, neither of which apply here.[202] The court says that "undervaluing [the corporation] to secure the merger . . . qualifies as a direct injury to the corporation"[203]—but how, exactly? None of the corporation's assets changed hands; only shareholders' stake was affected. The corporation is also not the sum of its shareholders. *Tucci* begins with a correct statement of corporate personhood and fiduciary law, but then essentially devolves into an "aggregate" view of the corporation. The court affirms the dismissal of the case, reasoning that it should have been filed as a derivative, rather than direct, action.[204] *Tucci* is one example, among many in this Article, of an under-recognition of corporate law's anatomy, possibly leading to large-scale wealth transfers (in this case, from public shareholders to an acquiring party), with no economic or legal justification.[205]

Some jurisdictions, particularly Delaware, tend to use phrases such as "fiduciary duties to the corporation and its shareholders."[206] If that expression is to be harmonized with the mass of other sources—including from Delaware itself—surveyed throughout this Article, it can only be construed as "duties to the corporation, which in turn owes equitable duties to shareholders."[207] Delaware's dualistic language might best be understood as a form of *reminder*: not about fiduciary duties (which run solely to the corporation), but about the corporation's *purpose*, which is the lawful pursuit of profit. That profit—ultimately (meaning a potentially unlimited time), and only through the facts of corporate law (such as the corporation's power to decide whether or not it distributes a dividend or makes a share buyback; its fiduciaries' ability to enact defensive tactics against a tender offer; and shareholders' own diverging interests and time horizons)—benefits shareholders.

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202. *See id.*

203. *Id.*

204. *See id.* at 928. Note that precisely because plaintiffs' shares were taken from them in the merger, they can no longer file a derivative action.

205. "Dell agreed to acquire all of EMC for approximately $67 billion." *Id.* at 921–22. If the case was not dismissed at the pleading stage, the parties would have had the chance to prove whether or not that amount is adequate.

206. *See, e.g.*, Cede & Co. v. Technicolor, 634 A.2d 345, 360 (Del. 1993) ("[D]irectors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders."); Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 979 (Del. Ch. 2000) ("Directors have an unyielding fiduciary duty to protect the interests of the corporation and the stockholders alike.").

207. *See* Raz, *supra* note 1, at 293–95. This point is also supported by Delaware's *Trados* case. *See infra* notes 219–23 and accompanying text.

There is also a deeper relation between share law and the law of corporate purpose. If an attempt was made to change a corporation's purpose without the due consent of its residual claimants,[208] those claimants' rights would be fundamentally affected, if not completely eliminated. The residual claim inherently depends on a certain assumption as to the corporation's purpose; the pursuit of that purpose, by the corporation, is what generates the value of the residual claim (albeit only ultimately and indirectly). When a for-profit corporation is required to cease lawfully pursuing profit, or to distribute its current assets to stakeholders, irrespective of their pre-existing positive law rights, this clearly negates the very content of shareholders' residual claim. Therefore, in addition to the corporation itself, residual claimants might have standing to challenge such attempts. In other words, residual claimants have, as part of their equitable claim, a right to have the corporation's purpose remain what it is.[209] Since the corporation's purpose must always be lawful,[210] this does not impinge upon the rights of anyone else. By definition, the pursuit of profit, or any other purpose, may not be subject to legal incursion, if it is made in full accordance with law.

In summary, the structure of corporate law entails that residual claimants—shareholders, members, or any other moniker attached to those whose claim toward the corporation is defined solely by the phrase "what is left after all obligations to other stakeholders are met"—do not "own" the corporate person or its assets; are not directly owed duties by its fiduciaries; and have interests that might diverge from those of the corporation, and from each other's. Yet, the *residual* nature of their claim, negating any attempt to fully rely on ex ante, "contract"-based planning, also means

208. Senator Warren's proposed Accountable Capitalism Act represents such an attempt. *See* Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018).

209. Residual claimants might agree to a change of the corporation's purpose (which, in the case of such a uniquely fundamental change, might justify a requirement for the informed consent of *all* shareholders). Alternatively, in some cases, it might be possible for a corporation to change its purpose, if its residual claimants receive other substantial, equitable remedy, such as appropriate compensation. This point differs from the view that "power is purpose within the corporate polity," Strine, *Corporate Power is Corporate Purpose*, *supra* note 144, at 180. That view assumes that solely because shareholders are granted the authority to elect directors, or similar corporate powers, they are the ones who benefit from the corporation's pursuit of its purpose. In fact, first, both stakeholders and shareholders have this benefit (as the corporation's purpose must be lawful). Second, shareholders have rights not because they have power; rather, they have some power because that is generally assumed to be a good way to protect their rights, and those of the corporation. Even if a lawmaker eliminated or modified shareholders' power to elect directors, this would not alter directors' duty to advance the corporation's purpose; and, as explained here, if an attempt was made to change the purpose itself, shareholders' rights would be protected by equity. Note that this applies regardless of the corporation's specific purpose: if a nonprofit corporation ignored its purpose and started pursuing profit, its residual claimants (for example, charity beneficiaries) would have an enforceable claim against the corporation.

210. *See supra* Section I.C.

they are not just another group of creditors in a "nexus of contracts." Their rights are less than fiduciary or proprietary, but more than contractual. In fact, residual claimants are unique creatures of corporate law itself. Specifically, their rights arise in the equity-based portion of corporate law. The total value of shares publicly traded on the world's exchanges, in 2019, was more than $60 trillion.[211] Understanding and respecting the nature of residual claimants' rights—which is equitable; no more, no less—is of the highest importance.

E. *The Corporation's Fiduciaries*

Every corporation, at any given moment, has at least one fiduciary—another person, owing fiduciary duties to the corporation. This fact is a direct result of corporate law's other building blocks: "A corporation is a person, but not a natural person. It does not have eyes and hands, or any other bodily and cognitive capacities, entirely of its own. Therefore, it always has to operate through someone else (the fiduciary), whom by design it entrusts with acting in its benefit."[212] In other words, if the corporation had no fiduciaries, it could simply not operate in the physical world. In turn, furthering the corporation's benefit means acting to cause it to achieve its purpose.[213]

The order of sections in this Part of the Article—beginning with the corporation's own purpose and personhood, moving to stakeholders, followed by residual claimants, and ending with fiduciaries—is not accidental. The corporation itself is at the center of corporate law, which aims to create a legal environment enabling the pursuit of the corporation's purpose. Without the corporate person, there would be no corporate law to speak of. The corporation must meet all of its positive law obligations to stakeholders, who enjoy full seniority in claims for its assets. Only then may residual claimants see any benefit. In contrast, the final group—fiduciaries—are not claimants, but obligors. Fiduciary law applies in a wide variety of relationships, where inherent power and information asymmetries make one party (the beneficiary) wholly dependent upon the actions of another (the fiduciary). These include, for example, the lawyer–client, doctor–patient, guardian–ward, and trustee–beneficiary relationships.[214] In this situation, concepts of "contract" are inadequate: by definition, the beneficiary cannot *possibly* know what actions the fiduciary might undertake; any ex ante attempts to "plan" the relationship are doomed to fail-

211. *See Stocks Traded, Total Value (Current US$)*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.TRAD.CD [https://perma.cc/PFF5-MKRC] (last visited June 30, 2020). This should be considered in addition to the value of shares issued by private, or non-publicly-traded, corporations.

212. Raz, *supra* note 1, at 270.

213. *See supra* Section I.A.

214. For additional examples of fiduciary relationships, see Evan J. Criddle, *Liberty in Loyalty: A Republican Theory of Fiduciary Law*, 95 TEX. L. REV. 993, 994 n.1 (2017).

ure, because the fiduciary might opportunistically use its superior power and information to upset the beneficiary's rights and expectations (including *would-be* rights and expectations).[215]

It is clear, then, why a corporation—which is an artificial person, *wholly* dependent upon other people for everything it does—has to be owed fiduciary duties by those people (and cannot solely rely on some other framework, such as contract). The corporation is compelled to blindly trust its fiduciaries to act in its benefit.[216] Fiduciary rights arise whenever certain conditions, primarily related to power and information asymmetries, combined with an assumption of "trust and confidence,"[217] are met. By design, such conditions occur every time a new corporation is formed, and continue throughout the entity's existence.

In current discourse, much of corporate law is formulated in terms of this last prong: corporate *fiduciary* law. The corporation's fiduciaries are presumably meant to act either "for shareholders" or "for all stakeholders."[218] This formulation is misguided. Fiduciaries' obligation is fixed: to advance the corporation's purpose. That obligation, of course, is owed to the corporation. The true Archimedean point is the law of corporate purpose, and the way it interacts with the other building blocks discussed in this Article.

2013's *Trados* decision[219] summarizes this web of relationships rather neatly. As the Delaware Court of Chancery wrote,

> [Directors' decisions should] benefit *the corporation* as a whole, and by increasing the value *of the corporation*, the directors increase the share of value available for the residual claimants. . . . [The "duties to the corporation and its shareholders"] formulation captures the foundational relationship in which directors owe duties *to the corporation* for the *ultimate* benefit of the entity's residual claimants. . . . [T]he duty of loyalty therefore mandates that directors maximize the value *of the corporation* over the *long-term* . . . . [R]esidual claimants [are] the *ultimate* beneficiaries of *the firm's* value . . . .[220]

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215. *See* Henry E. Smith, *Equity as Second-Order Law: The Problem of Opportunism* (Harvard Pub. Law Working Paper No. 15-13, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2617413 [https://perma.cc/ZL95-VNLZ].

216. *See* Raz, *supra* note 1, at 270.

217. Bristol & W. Bldg. Soc'y v. Mothew [1996] EWCA (Civ) 533, [1998] Ch 1, 18 (appeal taken from Eng.).

218. *See, e.g.*, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 105–06 (1979) (attempting to prove that *directors* should entertain a broad range of concerns, while discussing several legal norms that constrain *the corporation*). Of course, the corporation must obey the law. *See supra* Section I.C. Yet, this has nothing to do with broadening directors' concerns, beyond their duty to the corporation: to further the corporation's lawful purpose.

219. *In re* Trados Inc. S'holder Litig., 73 A.3d 17 (Del. Ch. 2013).

220. *Id.* at 36–41 (emphases added).

Read carefully, *Trados* is exceptionally accurate in its analysis of corporate law's anatomy. First, the corporation's purpose is the long-term pursuit of *its* profit ("increased value"). Second, the corporation is a person, as it must be to be owed duties by anyone.[221] Third, the corporation is required to meet all of its legal obligations (those discussed in *Trados* were mainly toward preferred shareholders, or "contractual claimants"[222]). Fourth, the corporation's residual claimants have claims toward the corporation (or "entity" or "firm"), not toward directors; and their benefit is only "ultimate," meaning that it is channeled not through instant-gratification concepts of "property" or "fiduciary law," but through the freedom-limiting, yet equitable, framework of Delaware share law. Finally, the corporation's fiduciaries (namely, its directors) owe their duties *to the corporation*, to further *its* value-increasing purpose. They are not "constituency directors,"[223] but corporate directors, subject to the structure of corporate law. Indeed, *Trados* gets right all five building blocks of corporate law.

As Section II.C below also discusses, attempts to ignore fiduciary law, or entirely replace it with inaccurate conceptions of contract, ultimately result in wealth transfers and outsized gains for fiduciaries (who remain fiduciaries, even when surface-level reading of the law seems to indicate otherwise). Contract absolutists, claiming that "regulation" (actually, *law*—just like any contract requires law)[224] is imperfect, practically ignore the fact that "contract" or pure "private ordering" is also far from perfect, certainly in a field (corporate law) which is *precisely about* strong and weak parties, open-endedness, and information asymmetries, requiring a certain core structure of the law, and negating any possibility of exclusive reliance on ex ante bargaining. As Professor Melvin Eisenberg succinctly put it, "just because mandatory rules are imperfect does not mean that markets would be better. Commentators who stress the Nirvana Fallacy are almost invariably themselves guilty of a mirror-image mistake which might be called the Heavenly Market Fallacy."[225]

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221. *See, e.g.*, Curtis Nyquist, *Teaching Wesley Hohfeld's Theory of Legal Relations*, 52 J. LEGAL EDUC. 238, 239–40 (2002) ("[Hohfeld] argues that a legal relation is always between two persons . . . . [I]f someone has a Hohfeldian right, another person has a duty.").

222. *Trados*, 73 A.3d at 41. Of course, the same applies not just for "contractual" claims, but those arising under any field of positive law. In *Trados*, the preferred shareholders indeed had a contractual, non-corporate law mechanism to determine their legal claim. *See id.* at 21–24, 38–39. However, "preferred shares" encompass a broad range of securities, with varying properties; a preferred shareholder's claim *might* be residual (at least in part), and therefore, determined within corporate share law. *See* Raz, *supra* note 1, at 281.

223. On the idea of constituency directors, owing fiduciary duties directly to certain shareholders or stakeholders (and therefore, necessarily not to the corporation), and the rejection of that idea both positively and normatively, see *Trados*, 73 A.3d at 42 n.16.

224. *See infra* note 285.

225. Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1525 (1989).

Despite these repeated attacks at the hands of contract absolutists, fiduciary law remains salient. Experience in fields besides corporate law—for example, financial regulation—demonstrates the same: a recent paper finds that "fiduciary duty leads broker-dealers to sell higher quality products,"[226] characterized by lower fees and better returns. As always, the economic analysis must rest on a structural legal framework, telling us *whose* benefit the law is there to maximize. Broker-dealers, just like corporate directors, might feel consternation at the restrictions imposed by fiduciary law.[227] Such feelings cannot modify the basic tenets of the relationship (which fiduciaries enter voluntarily): the beneficiary's welfare is at the center, and the fiduciary must wholeheartedly act to this sole end. In corporate law, the beneficiary-corporation's welfare equals the achievement of its purpose. Fiduciary law is the only toolbox designed for, and capable of, resolving the unique problems arising in a situation of absolute power and information asymmetries between multiple actors, one of whom is meant to promote the other's interests. Since the corporation is a person, but can only operate through others, on whom it utterly depends, corporate fiduciary law is a structural, unwaivable building block of corporate law.

II. Applying the Purpose Approach to Three Contemporary Issues

In a 1993 article, Professor Lyman Johnson remarks, "if discourse in corporate law does not reflect matters of deep *personal* significance—that is, if it is not carried on with our moral voice—I wonder if that discourse will be important in the larger *collective* sphere."[228] Previous sections of this Article touch upon issues such as the opioid crisis[229] and forced arbitration.[230] This Part explores three topics in greater detail: shareholder activism, corporations' constitutional rights, and the rise of LLCs and other "alternative" corporations. These issues lie at the intersection of corporate law and broader social life, deeply affecting both. This Article's theory produces new, fundamental insights on each of these high-currency topics.

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226. Vivek Bhattacharya, Gastón Illanes & Manisha Padi, *Fiduciary Duty and the Market for Financial Advice* 45 (Nov. 8, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281345 [https://perma.cc/ZT62-9P8Z].

227. *See, e.g.*, de Fontenay, *supra* note 1, at 224 ("Corporate law cannot be everything to everyone. While individuals may chafe at various prohibitions, isolated cases need not detract from the merits of an efficient regulatory design."). Note that the use of the term "regulatory" to describe fiduciary law is inaccurate. *See infra* note 285.

228. Lyman Johnson, *New Approaches to Corporate Law*, 50 WASH. & LEE L. REV. 1713, 1713 (1993).

229. *See supra* text accompanying notes 162–64.

230. *See supra* text accompanying notes 115–23.

A. *Shareholder Activism*

Shareholder activism is the most important phenomenon in U.S. corporate law over the last two decades.[231] The basic concept gives rise to many strands of debate and scholarship, largely depending on the type of activist (or not-activist-enough),[232] or a certain outcome of its operations, such as index funds,[233] the "problem of twelve,"[234] "wolf pack" hedge funds,[235] and "common ownership."[236] This Section places shareholder activism within the structure of corporate law, outlined in this Article. It then considers a common scenario—an institutional shareholder owing fiduciary duties to both its own investors and a corporation toward which it is active—to show how this Article's theory can aid in resolving an oft-encountered, high-stakes situation.

In the structure of corporate law, shareholders and fiduciaries are two distinct actors. Each occupies a separate, almost polar, role in respect to the corporation: shareholders are residual *claimants*, equitably entitled to a residual value that fluctuates with the corporation's fortunes (that is, the degree to which it attains its purpose).[237] The corporation's fiduciaries, on the other hand, mainly have *obligations*—specifically, a fiduciary duty to loyally and devotedly cause the corporation to achieve its purpose.[238] Unless fiduciaries also own shares (which they often do), nothing entitles them to enjoy the corporation's residual value. Equally, as a rule, shareholders are not fiduciaries for the corporation.[239]

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231. *See, e.g.*, Bratton, *supra* note 13, at 156 ("Hedge fund activism is to corporate law's early twenty-first century what the hostile takeover was to its late twentieth century.").

232. *See, e.g.*, Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019) (arguing that index fund managers should play a greater role in corporate governance).

233. *See, e.g.*, *id.*

234. *See* John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve* 2 (Harvard Pub. Law Working Paper No. 19-07, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 [https://perma.cc/4YEB-FABV] (discussing the possibility that "control of most public companies . . . will soon be concentrated in the hands of a dozen or fewer people").

235. *See, e.g.*, Strine, *supra* note 172 (discussing the detrimental effects of some hedge fund activists on the long-term performance of some public corporations).

236. *See, e.g.*, Edward B. Rock & Daniel L. Rubinfeld, *Common Ownership and Coordinated Effects* (NYU Law & Econ. Research Paper No. 18-40, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3296488 [https://perma.cc/Y8LV-HVQN] (discussing the intersection of corporate law and competition law, as resulting from large institutional shareholders owning shares of multiple corporations operating in the same industry).

237. *See supra* Section I.D.

238. *See supra* Section I.E.

239. *See, e.g.*, Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 47–48 (2017) ("Shareholders do not act as fiduciaries when they exercise their voting rights, and they are under no obligation to vote their shares in the best interests of the corporation." (footnote omitted)).

The rule has an exception. Some shareholders are *also* fiduciaries. That duty can be imposed on a variety of shareholders—such as a controlling shareholder, or a plaintiff in a derivative action—but the principle is this: "[W]hen a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of the corporation."[240] The principle coheres with the overall structure of corporate law: the corporation is an artificial person, wholly dependent on others, through whom it acts in the world. Normally, those others are called "directors" or "managers," but nothing precludes additional people—such as a shareholder with a large enough voting stake—from directing the corporation's actions, at least in part (or in concert with others, as in the "wolf pack" scenario).

Here lies the key to understanding and handling the shareholder activism phenomenon: activism is not about shareholders *as such*. The structure of corporate law gives individual shareholders no right to direct the corporation's actions, but only to (ultimately) reap their fruits. An activist is a shareholder who willfully became a fiduciary for the corporation. The quantitative inquiry policymakers and scholars should make is not whether share prices rose as a result of an activist campaign, but whether the corporation now better achieves its purpose—the lawful pursuit of *its* profit. The two metrics very often align. A fiduciary-shareholder can see a rise in share value (within the time horizon favored by the shareholder), *and* meet all duties toward the corporation. When they do not,[241] corporate law mandates that the latter override the former.

Reality presents further complications. In the common scenario, the activist is not an individual acting in one's own benefit,[242] but is itself a fiduciary for other people down the line, such as pension savers or private equity investors. There might be a very definite time horizon over which

240. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *63 (Del. Ch. June 21, 1991). For an article applying a similar principle specifically to activist shareholders, see Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008).

241. For discussion of such situations, see Raz, *supra* note 1, at 272, 276–78, 282–85, 291 n.145, 293–95, 304–05, 311–19 (discussing various conflicts or disparities between the corporation and all or part of its shareholders); Strine, *supra* note 172. At the macroeconomic level, it is possible that shareholder activism, including by hedge fund managers, has a neutral or positive effect. *See, e.g.*, Mark J. Roe, *Stock Market Short-Termism's Impact*, 167 U. PA. L. REV. 71 (2018). This Article focuses on the firm level, where specific instances of activism can have varying effects.

242. There are exceptions. *See, e.g.*, Frank Partnoy & Steven Davidoff Solomon, *Frank and Steven's Excellent Corporate-Raiding Adventure*, ATLANTIC (May 2017), https://www.theatlantic.com/magazine/archive/2017/05/frank-and-stevens-excellent-corporate-raiding-adventure/521436 [https://perma.cc/TD2P-PW3W].

the fiduciary has to maximize its investors' stake, such as ten years for some hedge funds.[243]

Assume the following hypothetical: a hedge fund has been set up for a ten-year period, after which it has to liquidate, distributing all assets to its investors. Nine years have elapsed; the hedge fund manager has one more year to maximize returns. It now contemplates initiating an activist campaign at the largest corporation in its portfolio, which would lead the target to sell its central asset (say, a research and development division). According to ample information, that move is likely to result in a 10% increase in share price over the next year. If, however, the asset is *not* sold, equally robust predictions indicate that the target corporation would see a 6% annual increase in profits, and a similar (anyway, less than 10%) annual increase in share price, over a twenty-year period. At the end of that period, the corporation's residual value would be higher, in net present value terms, than if the main asset is now sold. How can the two fiduciary duties owed by the activist—one to its own investors; the other to the corporation whose actions it partly "direct[s]"[244]—be settled?

This requires addressing an "egg and chicken" problem. What came first: the corporation itself, its shares, and the rights and duties they confer, or the hedge fund manager's ownership of those shares? The answer is easy: at any moment of its existence as the target corporation's shareholder, the hedge fund manager held something that existed beforehand (the share, or its corporate law-derived nature). When share ownership, or certain activities it enables, also make someone a fiduciary for the target corporation, that duty precedes *other* fiduciary duties, which the activist could never have had if corporations and shares did not exist in the first place.[245]

The analysis so far does not *conclusively* entail that the hedge fund manager should forego the activist campaign. Corporate law does not explicitly set the corporation's time horizon at twenty years, rather than one year, or any other number. Yet, corporate law does provide certain defaults, or presumptions, in this regard. For example, in its 2013 *Trados* decision, the Delaware Court of Chancery states that "[a] Delaware corporation, by default, has a perpetual existence. . . . [T]he duty of loyalty . . .

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243. *See, e.g.*, Andrew A. Schwartz, *The Perpetual Corporation*, 80 GEO. WASH. L. REV. 764, 811 (2012).

244. *Cinerama*, 1991 Del. Ch. LEXIS 105, at *63.

245. Put differently, any person, including hedge fund managers, is required to act lawfully. This Article expands on that requirement as it applies to *all* corporations. *See supra* Section I.C. In regard to hedge fund managers, the lawfulness requirement includes meeting all fiduciary obligations toward the corporations in which they invest. A hedge fund manager and its investors know what they are getting into when the manager adopts an active investment strategy; they must accept corporate law, and the rights and duties it imposes, as a given. Corporate law, on the other hand, is not required (and is informationally unable) to change itself according to one fiduciary or another's obligations to third parties.

mandates that directors maximize the value of the corporation over the long-term."[246]

On a deeper level, the very concept of the corporation—indeed having perpetual existence, as well as its own identity and traits—suggests that a corporation's time horizon should tend to the longer term. Professor Lynn Stout's 2015 article[247] compares the corporation to a "time machine," suggesting that "corporate entities can be understood as institutions designed to transfer wealth forward from earlier time periods to later time periods,"[248] and concluding, "if we do not continue to have thriving corporations . . . future generations will be left worse off than they could, or should, be."[249]

This accords with the theory presented here: nothing makes the corporation's present state more important than its future state; just as a natural person may expend less today to live better tomorrow, so can a corporation. If it can be shown that a given action would improve the corporation's prospects, that action ought to be taken, even if present-day shareholders (or stakeholders) do not instantly receive what they might wish for. From this perspective, many activist campaigns are beneficial, and should be encouraged. Others are less so. In any case, shareholders who materially influence the affairs of a corporation may not operate for their own benefit (although it may well accrue to them, as derived from the corporation's). Activists, like directors, CEOs, and anyone else in corporate law, operate within the bounds of a structure.

B. *Corporations' Constitutional Rights*

The two most famous corporate law cases of this century, *Citizens United*[250] and *Hobby Lobby*,[251] are not, in fact, cases about corporate law. More precisely, it plays a *part* in both cases, but their disposition mainly lies in other fields: constitutional law, along with election, health, and employment law. This Section proceeds in three steps: first, it criticizes the misapplication of corporate law by the Court in both cases (namely, the erroneous utilization of a nineteenth-century-like "aggregate" model); it then shows how, even when we apply *correct* corporate theory, the outcomes in both cases could have been reached; finally, it explains, in similar fashion to Section I.C above, that these cases—and their possible future undoing—do not (and should not) have much to do with corporate law.

246. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013).

247. Lynn A. Stout, *The Corporation As a Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form*, 38 SEATTLE U. L. REV. 685 (2015).

248. *Id.* at 686.

249. *Id.* at 722.

250. Citizens United v. FEC, 558 U.S. 310 (2010).

251. Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682 (2014).

In both *Citizens United* and *Hobby Lobby*, the Supreme Court effectively ignores one of corporate law's building blocks: the fact that the corporation is a person, with rights and duties separate from, and possibly conflicting with, those of any other person, including its shareholders.[252] Instead, the Court relies on a theory "which was prevalent in the 19th century"[253]—the "aggregate" model of the corporation, according to which a corporation is merely a grouping of other individuals. In *Citizens United*, Justice Kennedy describes the corporation as "an association that has taken on the corporate form."[254] Similarly, in *Hobby Lobby*, Justice Alito calls corporate personhood a "fiction"[255] and surmises that "[w]hen rights . . . are extended to corporations, the purpose is to protect the rights of [the] people [associated with the corporation]."[256] Adding insult to misunderstanding, he implies that corporations are "own[ed]"[257] by their shareholders.

Indeed, "[c]orporate personhood . . . is entirely missing from the [*Citizens United*] opinion. . . . [T]he *Citizens United* decision obscured the corporate entity and emphasized the rights of others, like shareholders and listeners."[258] The same holds true for *Hobby Lobby*. As this Article demonstrates extensively, the Court's assertions have little to do with actual corporate law. In fact, they even clash with case law from the Supreme Court itself.[259] What might have led the Court to embark on this deconstructive enterprise? Very plausibly, the Court simply tried to find an explanation for how for-profit corporations, supposedly meant to pursue "business-related" activities, can also engage in political activity and have religious beliefs. Such explanation, however, does not require an "aggregate" model of the corporation.

The outcomes in both cases *could* be achieved with correct corporate law. As a rule, corporations have the same legal capacity as natural persons.[260] Accordingly, a corporation should enjoy the same rights—and bear the same duties—as a natural person with similar traits, in constitutional law as in any other field. Within *corporate* law, the corporation's ac-

252. *See supra* Section I.B.

253. Hill, *supra* note 79, at 42.

254. *Citizens United*, 558 U.S. at 349.

255. *Hobby Lobby*, 573 U.S. at 706.

256. *Id.* at 706–07.

257. *Id.* at 707.

258. WINKLER, *supra* note 54, at 364.

259. *See* Macey & Strine, *supra* note 49, at 485–95 (surveying "The Supreme Court's Treatment of the Corporate Entity in Other Areas of Law").

260. *See supra* note 87 and accompanying text. The Pennsylvania statute—under which Conestoga Wood Specialties Corporation, one of the plaintiffs in *Hobby Lobby*, is incorporated—says so explicitly. *See* 15 PA. CONS. STAT. § 1501 (2020) ("[A] business corporation shall have the legal capacity of natural persons to act."); *see also* Macey & Strine, *supra* note 49, at 530 ("[C]orporations are creatures of state law, and therefore state law rules should guide our understanding about the essential nature of these entities.").

tions are subject to an ever-looming restriction: the law of corporate purpose.[261] *If* having political or religious beliefs, either at all or specific ones, steers a certain corporation away from its purpose, then holding and exercising such beliefs violates corporate law. The corporation (and possibly its fiduciaries, who breached their duty to further the corporation's purpose)[262] should then face appropriate sanction.[263] Yet, neither *Citizens United* nor *Hobby Lobby* suggest that these were the facts of the case. For some corporations, exercising such beliefs might *advance* the corporation's purpose—for example, if the corporation operates in a community of like-minded people, who are therefore more likely to purchase its products and services.

Does the above necessarily mean that *Citizens United* and *Hobby Lobby*, if only we corrected their corporate law mistakes, are good decisions that should be reaffirmed in the future? Of course not. Consistent with this Article's distinction between corporate law and general, non-corporate law (the latter governing the corporation's relationships with its various stakeholders),[264] *Citizens United* and *Hobby Lobby* are not primarily corporate law cases. They are cases in constitutional law—specifically, the First Amendment.[265] The real question behind these cases is not whether *corporations* should be able to exercise their First Amendment rights in a certain way, but whether rich, influential *people* (human or corporate) should be able to do so.[266] If a natural person was engaged in political financing to the same extent as Citizens United, or had the same number of employees as Hobby Lobby Stores, Inc., that would give rise to precisely the same questions: how should the law balance the constitutional and human interest in a functional, representative democracy with political freedom of speech? How should the law balance employment and reproductive rights with religious ones? A small-scale corporation is less likely to provoke these questions, although it is fully a corporation, presenting all the issues (or building blocks) inherent to corporate law.

Constitutional law is largely about determining when the state may treat different people in different ways, including on account of their wealth, or their ability to affect others' lives (say, through political influence). Quite possibly, the Court got the answers wrong. Yet, as Justice Stevens notes in his *Citizens United* dissent, "[n]othing in this analysis turns

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261. *See supra* Section I.A.

262. *See supra* Section I.E.

263. It is at this point that much of the corporate law scholarship about *Citizens United* and *Hobby Lobby* comes into the picture. *See, e.g.*, Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83 (2010) (suggesting a framework for corporate decision-making on *whether* and *how* to engage in political speech, while presupposing that corporations *can* engage in such speech).

264. *See supra* Section I.C.

265. U.S. CONST. amend. I.

266. This is supported by case law from the Supreme Court, particularly the *Munn v. Illinois* decision. *See supra* note 142 and accompanying text.

on whether the corporation is conceptualized as a grantee of a state concession, a nexus of . . . contracts, a mediated hierarchy . . . , or any other recognized model."[267] Justice Stevens does not mention the one correct answer—"a legal person"—but his main point is clear: *Citizens United* is a case about influence on the political process, and the constitutional limitations it should face. That issue is separate from the corporate law question.[268] If the cases are overturned by a future Court, this would detract nothing from the structure of corporate law (if anything, it would be an opportunity to *reinforce* the correct roles of corporate purpose, personhood, and shareholders within that structure).[269] Save for the useful mistake they make, as described in this Section, *Citizens United* and *Hobby Lobby* do not—and are not supposed to—tell us much about corporate law.

C. *Alternative Corporations*

In the United States, specifically Delaware, a person wishing to start a corporation[270] can choose among a wide variety of forms: besides the entity type which the statute calls a "corporation,"[271] it is possible to establish a partnership,[272] statutory trust,[273] or limited liability company.[274]

267. Citizens United v. FEC, 558 U.S. 310, 465 n.72 (2010) (Stevens, J., dissenting) (citations omitted).

268. *See, e.g.*, Macey & Strine, *supra* note 49, at 530 ("[W]hatever one might say about *Citizens United* from a constitutional law perspective, the case is bad corporate law.").

269. *See, e.g.*, Kent Greenfield, *In Defense of Corporate Persons*, 30 CONST. COMMENT. 309, 326 (2015) ("One can support campaign finance regulation . . . and still acknowledge corporate personhood and corporate constitutional rights as well.").

270. On the broad meaning of "corporation" as used in this Article, see *supra* note 1. The distinction made there is particularly important in the context of this Section.

271. *See* Delaware General Corporation Law, DEL. CODE ANN. tit. 8, ch. 1 (2020).

272. *See* Delaware Revised Uniform Partnership Act, DEL. CODE ANN. tit. 6, ch. 15 (2020); Delaware Revised Uniform Limited Partnership Act, tit. 6, ch. 17. It is possible for a general (non-limited) partnership not to be a corporation, if the partners specifically agree so. *See* § 15-201(a) ("A partnership is a separate legal entity which is an entity distinct from its partners unless otherwise provided in a statement of partnership existence or a statement of qualification and in a partnership agreement."). Yet, by default, a partnership is a corporation, presenting all of corporate law's building blocks, *see supra* Part I: purpose (*see, e.g.*, § 15-202(a) ("[An association to carry on] a business for profit forms a partnership . . . and [an association] to carry on any purpose or activity not for profit [may form] a partnership . . . .")); personhood (*see* §§ 15-201(a), 17-201(b) ("A limited partnership formed under this chapter shall be a separate legal entity . . . .")); stakeholders (*see, e.g.*, § 15-305 (stating that a partnership may be "liable for loss or injury caused to a person")); residual claimants (*see* §§ 15-101(6), 17-101(13) (defining a partner's economic interest as "partner's share of the profits and losses" of a partnership)); and fiduciaries (*see* §§ 15-401(f) ("Each partner has equal rights [(i.e., powers)] in the management and conduct of the partnership business and affairs."), 17-101(9) (stating that every limited partnership must have "1 or more general partners"),

The latter form—the limited liability company (LLC)—is today the most prevalent type of corporation in Delaware and across the U.S., vastly outnumbering narrow-sense "corporations."[275] In daily life, it becomes increasingly common to see the letters "LLC"—not "Inc."—appended to the name of the corporation one works for, supplies goods to, or gets products and services from. LLCs permeate all levels of economic, financial, and personal life: in fact, the New York Stock Exchange, which runs the world's largest and most important securities marketplace, *is itself* an LLC.[276] So is Google.[277] Many LLCs have their shares (or "limited liabil-

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17-403(c) (discussing "the general partner's . . . powers and duties to manage and control the business and affairs of the limited partnership")). In the case of general partnerships, residual claimants and fiduciaries are the same people.

273. *See* Delaware Statutory Trust Act, tit. 12, ch. 38. It is possible for a statutory trust not to be a corporation, if the parties to its governing instrument specifically agree so. *See* § 3801(g) ("Any . . . statutory trust . . . , unless otherwise provided in its certificate of trust and in its governing instrument, [shall be] a separate legal entity."). Yet, by default, a statutory trust is a corporation, presenting all of corporate law's building blocks, *see supra* Part I: purpose (*see* § 3801(g)(1)); personhood (*see* §§ 3801(g), 3810(a)(2), 3812(f)); stakeholders (*see, e.g.*, § 3804(a) (discussing "debts and other obligations or liabilities" for which the trust may be sued)); residual claimants (*see* §§ 3801(a), 3801(g), 3805 (discussing the trust's beneficial owners and the nature of their rights, known as "beneficial interests"); *see also* Raz, *supra* note 1, at 272–75 (explaining that every legal person always has residual claimants)); and fiduciaries, *see* § 3807(a). Apparently, unless the creation of a separate entity has been avoided according to § 3801(g), the trust itself is the person serving as trustee for the beneficial owners (which also accords with the common law of trusts, since the trust—not the "trustee"—legally owns the trust property), while the "trustees" are fiduciaries for the trust (with few channeling principle exceptions, *see supra* text accompanying notes 192–95). To illustrate this distinction, consider a situation where a beneficial owner would benefit from a distribution of the trust's assets, while the trust itself would be harmed: to whom do the trustees owe their duties? Clearly, to the trust, considering first principles. *See supra* Sections I.B, I.E; *see also, e.g.*, Cargill, Inc. v. JWH Special Circumstance LLC, 959 A.2d 1096 *passim* (Del. Ch. 2008) (discussing fiduciary duties owed "to the trust" and finding possible breaches of those duties). Note that, as with other corporations (such as mutual insurance companies, *see* Raz, *supra* note 1, at 275 & n.79), the beneficial owners of a statutory trust have a dual relationship with the corporation: by default, along with their equitable rights under share law, they have rights as trust law beneficiaries. *See* § 3809 ("Except to the extent otherwise provided in the governing instrument of a statutory trust or in this subchapter, the laws of this State pertaining to trusts are hereby made applicable to statutory trusts . . . .").

274. *See* Delaware Limited Liability Company Act, tit. 6, ch. 18.

275. *See, e.g.*, Mohsen Manesh, *Creatures of Contract: A Half-Truth About LLCs*, 42 DEL. J. CORP. L. 391, 393 n.5 (2018) (citing data showing that as of Dec. 31, 2016, there were 827,611 Delaware LLCs and 298,025 "Delaware corporations" in existence).

276. *See EDGAR Search Results for New York Stock Exchange LLC*, EDGAR, https://www.sec.gov/cgi-bin/browse-edgar?CIK=0000876661 [https://perma.cc/T7TB-8B8X] (last visited June 30, 2020).

277. *See* Certificate of Conversion of Google Inc. (a Delaware corporation) to Google LLC (a Delaware limited liability company) (Sept. 29, 2017), http://assignments.uspto.gov/assignments/assignment-tm-6178-0319.pdf [https://perma.cc/G2ZY-7ZS4].

ity company interests"[278]) publicly traded.[279] In short, LLCs operate in the world, get their incentives, and affect the lives of others, in *precisely the same way* as any other corporation.[280] Given the small, bordering on non-existent, *practical* difference between a narrow-sense "corporation" and an LLC, we might wake up in the not-too-distant future in an LLC-dominated world. To sustain meaningful discourse in this area, it is time to clarify the actual *legal* difference between LLCs and other corporations.

An oft-repeated statement is that LLCs are "unincorporated" entities, or "uncorporations."[281] That is an incident of historical terminology: the constitutional documents of narrow-sense "corporations" are known as "charters" or "certificates of incorporation," and the act of "granting" a charter is known as "chartering" or "incorporation." This evokes an aroma of government involvement, of the kind prevalent before the rise of general incorporation.[282]

Today, however, the process of establishing both types of corporations—a narrow-sense "corporation" and an LLC—requires the same, minimal level of government action: in both cases, certain documents have to be filed with the Secretary of State, often through the internet; if those documents are properly formatted and a fee is paid, a new corporation is created.[283] No *substantive* government act—that is, no choice be-

278. *See* tit. 6, §§ 18-101(10) (defining "[l]imited liability company interest" as "a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets"), 18-701 ("A limited liability company interest is personal property. A member has no interest in specific limited liability company property."). *Cf.* Raz, *supra* note 1, at 272–76, 285–87 (discussing characteristics of corporate shares, identical to those of LLC interests). Thus, we may speak of "LLC share law" (as with other corporations, discussed *id.*). It is possible to be an LLC member without acquiring an LLC interest (also often known as "LLC unit"). *See* § 18-301(d). Yet, assuming that *every* member has *some* claim toward the LLC (otherwise, what is the meaning of "membership?"), those legal claims (even if not "packaged" as LLC interests, or shares) have to be governed by some legal framework, that is, LLC share law. More generally, "share law" and "residual claimancy law" can be regarded as synonymous.

279. *See, e.g.*, *New Fortress Energy LLC Class A Shares Representing Limited Liability Company Interests (NFE)*, NASDAQ, https://www.nasdaq.com/market-activity/stocks/nfe [https://perma.cc/WEU5-VHCR] (last visited June 30, 2020) (providing information on a public LLC with market capitalization of approximately $2.2 billion).

280. *See, e.g.*, Jeffrey M. Lipshaw, *Trust v. Law (in a Box): Do Organizational Forms Really Make a Difference?*, 2014 U. ILL. L. REV. 1795, 1798 ("Virtues like trust and their counterpart vices—greed, fear, panic—seem to me as likely to kick in after the fact whether we are talking about partnerships, limited partnerships, LLCs, [or] corporations . . . .").

281. *See* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION (2010) (discussing the increased popularity and legal theories relating to LLCs and other alternative entities).

282. For a discussion of chartering by special legislation in the nineteenth century, and the transition to general incorporation, see, for example, Hovenkamp, *supra* note 142, at 1634–40.

283. *See, e.g.*, Coates, *supra* note 3, at 831 n.164 ("Most state statutes impose only pro forma requirements for incorporation, which typically include the filing

tween competing alternatives, made by a public official—is involved in the creation of either a narrow-sense "corporation" or an LLC. The state is not party to the "corporate contract" in any meaningful way. The state does legislate and adjudicate corporate law, which—although highly structured and partly unwaivable, as this Article explains—is simply a legal field governing relations between private actors. These actors, not the state, create the corporation.[284] In this regard, contract law is the same: the existence of a contract statute[285] does not mean that the state is party to every contract. Therefore, the "unincorporated" terminology is as non-dispositive as the use of the word "charter," rather than "operating agreement," or any other moniker, for the corporation's constitutional documents. Even on these linguistic grounds, there is no actual difference between an LLC and any other corporation.

More importantly, LLCs are corporations, just like narrow-sense, "Delaware corporations," because they have precisely the same anatomy, and give rise to the same set of problems. Going back to the distinction between "structural" and "dynamic" meanings,[286] there certainly are *dynamic*

of a certificate of incorporation, signed by an 'incorporator,' who may be almost anyone, and a payment of a fee. The most regulated part of this process is the choosing of the corporate name."). The creation of an LLC identically requires only the filing of a certificate of formation and payment of filing fees. *See* tit. 6, §§ 18-201(a), 18-206(a).

284. For recent sources expressing a view that "the state" has a significant relationship with every corporation, including as the corporation's creator, see, for example, *Sciabacucchi v. Salzberg*, No. 2017-0931-JTL, 2018 Del. Ch. LEXIS 578 (Del. Ch. Dec. 19, 2018), *rev'd*, 227 A.3d 102 (Del. 2020); Hershkoff & Kahan, *supra* note 112; Macey & Strine, *supra* note 49. However, none of these sources cite a concrete example of any substantive role the state plays within corporate law, in terms of bearing rights and duties. In context, it seems each of these sources simply aim to argue, correctly, that corporate law differs from a pure "private ordering" regime. It is true that *law* is required for any corporation to exist; yet, the same is also true of any contract and any property. Corporate law is part of private law, which is established (at least partly) by the state, but generally does not give the state itself a role within the various relationships it enables. *See* John C.P. Goldberg, *Introduction: Pragmatism and Private Law*, 125 HARV. L. REV. 1640, 1640 (2012) ("Private law is law, so government is involved, *albeit in a particular way*. Typically, it makes available institutions and procedures that enable individuals and entities to define their relationships and to assert and demand the resolution of claims against others." (emphasis added)).

285. *See* U.C.C. (AM. LAW INST. & UNIF. LAW COMM'N 2012) (Uniform Commercial Code, adopted in whole or part by all U.S. states, and providing legal norms governing various types of contracts). Contract law, just like corporate law, has unwaivable structure—for example, the rule that a contract legally binds the parties to it. Otherwise, it is not a contract at all. *See infra* note 306. This point also bears on the mistaken view that fiduciary law, or anything other than "private ordering," is a form of "regulation," *see, e.g.*, Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 562 (2001) (implying that fiduciary law is "[m]andatory regulation that forces people to attend to others' interests"). However, precisely as in a contract case, a court adjudicating a breach of fiduciary duty does not engage in governmental "regulation," but merely resolves a dispute between private parties, arising within a private (albeit asymmetric) relationship.

286. *See supra* notes 32–33 and accompanying text.

differences between LLCs and narrow-sense "corporations"—for example, in regard to members' or shareholders' rights to receive a distribution of the corporation's assets,[287] the transferability of shares,[288] or issues outside corporate law, such as tax treatment (itself related to the corporate dynamic choices; the greater ease of withdrawing assets from an LLC, compared to a narrow-sense "corporation," might motivate different tax rules).

Yet, on the more fundamental, structural level,[289] LLCs and other corporations are exactly the same. Does an LLC have a purpose? Yes.[290] Is it a person, with general capacity to act and bear rights and duties? Yes.[291] Does it have stakeholders? Yes.[292] Does it have residual claimants? Yes; they are called "members."[293] Does it have fiduciaries? Yes; they might be the members, or "managers."[294] We can modify the rules of capital lock-in, transferability of shares, ability to contract around certain legislative or common law provisions, and many other dynamic topics, but we are still dealing with a corporation. This Article's discussion of corporate law's structure, and the issues it *inherently* gives rise to, equally applies to LLCs. The insistence on making some deep-seated distinction between

287. *See, e.g.*, Robert L. Symonds, Jr. & Matthew J. O'Toole, SYMONDS & O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES § 7.02[B] (2d ed. 2018) ("[T]he statute provides significant latitude to fashion . . . distribution rights . . . . Limited liability company interests may carry distinctly tailored rights pertaining to . . . distributions."). Such pre-agreed distribution (dividend or buyback, including share redemption) can also be made by a narrow-sense "corporation," if it does not breach the mandatory rules governing distributions. *See* Raz, *supra* note 1, at 274 n.77. Yet, pre-agreed distributions are more prevalent in alternative corporations.

288. *See, e.g.*, tit. 6, § 18-702(b)(1) ("An assignment of a limited liability company interest does not entitle the assignee to become or to exercise any rights or powers of a member[.]").

289. *See supra* Part I (discussing the building blocks of corporate law).

290. *See* tit. 6, § 18-106(a) ("A limited liability company may carry on any lawful business, purpose or activity, whether or not for profit . . . .").

291. *See* § 18-201(b) ("A limited liability company formed under this chapter shall be a separate legal entity . . . ."); *see also* Manesh, *supra* note 275, at 415–16 (discussing "separate legal existence" as a defining, unwaivable, and practically important characteristic of every LLC).

292. *See* §§ 18-303 ("[T]he debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company . . . ."), 18-607 (discussing the "liabilities of the limited liability company").

293. *See* § 18-101(8) ("'Limited liability company' . . . means a limited liability company formed under the laws of the State of Delaware and having 1 or more members."); *supra* note 278 (discussing the nature of LLC members' rights, the same as those of other corporations' residual claimants).

294. *See* §§ 18-402 ("Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members . . . ; provided however, that if a limited liability company agreement provides for the management . . . of a limited liability company by a manager, the management . . . shall be vested in the manager . . . ."), 18-1104 ("In any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties . . . , shall govern.").

LLCs and other corporations is all language and no substance.[295] This rather obvious fact has been recognized by scholars[296] and leaders of Delaware law.[297]

In one important area, however, LLC law *purports* to break with corporate law. That area is the fifth building block discussed above: corporate fiduciary law.[298] LLC statutes in many places,[299] including Delaware, presumably give parties to the LLC agreement the option to eliminate all fiduciary duties owed by the corporation's managers or other fiduciaries.[300] The only correct answer to this trend is: "not so fast."

As explained above, *every* corporation *must* be the beneficiary of fiduciary duties, at any given moment.[301] The corporation *cannot* "waive" all of its fiduciary law protections, because even in purely contractual terms, such offer and acceptance cannot occur. Given the open-ended, extremely asymmetric nature of these relationships, the beneficiary is entitled to a protective mechanism that transcends purported "consent" to entirely unknowable future scenarios.[302]

Indeed, the belief that fiduciary duties can be "eliminated" counters the most fundamental notion of what a director or manager is meant to

295. *See, e.g.*, Joshua Fershee, Posts in the Category "LLCs", BUS. L. PROF BLOG, https://lawprofessors.typepad.com/business_law/llcs [https://perma.cc/F8J2-N9HT] (last visited June 30, 2020) (criticizing, in dozens of blog posts since 2013, courts and others who use phrases such as "limited liability corporation"). Professor Fershee is entirely correct that an LLC is not a narrow-sense "corporation," as the term is used in most U.S. law. Yet, the substantive question is whether LLCs omit any of the legal and economic issues inherent to all corporations (broadly defined, *see supra* note 1), which they do not.

296. *See, e.g.*, Stout, *supra* note 247, at 689 n.7 ("[S]ome LLCs are the functional equivalents of close corporations . . . . [A]n LLC whose shares are listed for trading on a recognized exchange . . . becom[es] a public corporation in all but name."). For another criticism of alternative corporation exceptionalism (in the very similar context of statutory trusts, *see supra* note 273), see Anne Tucker, *Justice Scalia's Final Mark on Corporate Law May Be One of Form over Substance*, BUS. L. PROF BLOG (Feb. 17, 2016), https://lawprofessors.typepad.com/business_law/2016/02/justice-scalias-final-mark-on-corporate-law-form-over-substance.html [https://perma.cc/5ZVK-7C3N].

297. *See* Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 14–17 (Robert W. Hillman & Mark J. Loewenstein eds., 2015) (noting that LLCs and narrow-sense "corporations" have the same characteristics, except for tax treatment, which is not part of corporate law).

298. *See supra* Section I.E.

299. *See* Manesh, *supra* note 275, at 394 n.6 (listing state LLC statutes that presumably allow for waiver of fiduciary duties).

300. *See* DEL. CODE ANN. tit. 6, §§ 18-1101(c), 18-1101(e) (2020).

301. *See supra* text accompanying notes 212–17.

302. *See, e.g.*, Amir N. Licht, *Motivation, Information, Negotiation: Why Fiduciary Accountability Cannot Be Negotiable*, *in* RESEARCH HANDBOOK ON FIDUCIARY LAW 159, 179 (D. Gordon Smith & Andrew S. Gold eds., 2018) ("These asymmetries [due to unobservable and unverifiable information] provide a compelling justification for a strict, full-disclosure-based accountability regime. . . . Fiduciary law thus preserves an irreducible core of accountability to ensure fiduciary loyalty.").

do: act for the benefit of the corporation, because no one else is there to do so.[303] *Truly* eliminating fiduciary duties means abolishing the concept of directors and managers, period. That, in turn, entails disposing of corporations altogether, since they could *do* nothing: there would be no one to operate on their behalf. The act of "eliminating" all fiduciary duties "by contract" is impossible, as it negates the entity itself. Contract is not a license to make stuff up.[304]

Thus, when courts fail to enforce one party's fiduciary obligation to another, they are *not* "giv[ing] the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."[305] They are doing the exact opposite: by overlooking the norms and enforcement mechanisms that make this unique type of document operative, they essentially turn these instruments into something akin to an illusory contract.[306]

As importantly, LLC statutes *never had the power* to allow for the elimination of fiduciary duties. Those duties arise in equity, not "created" by any legislative act.[307] Equity cannot be contracted around or legislated away. It is precisely the concept of equity to protect rights even when, for some reason, contractual and legislative "law" purports to negate them. In Delaware, as anywhere else, directors and managers of *all* corporations (including alternative ones) *are* fiduciaries, and never stopped being.

When a legislature creates "law" that simply makes no sense, on the most *definitional* level—for example, saying "any contract may be breached without remedy" or "a corporation can exist without fiduciaries"—this is not the final word. Equity is always part of the law.[308] Courts are always

303. *See, e.g.*, de Fontenay, *supra* note 1, at 219 ("If managers are not acting with the corporation's interests in mind, what is their conceivable purpose or role?").

304. *Cf.* Ravenswood Inv. Co., L.P. v. Estate of Winmill, Nos. 3730-VCS, 7048-VCS (Consol.), 2018 Del. Ch. LEXIS 96, at *4 (Del. Ch. Mar. 21, 2018) ("Equity is not a license to make stuff up.").

305. § 18-1101(b).

306. *See* 17A AM. JUR. 2D *Contracts* § 125 ("A contract which is not mutually enforceable is illusory. An 'illusory promise' is one which . . . by its terms makes performance optional or entirely discretionary on the part of the promisor. In other words, a promise is illusory when it fails to bind the promisor, who retains the option of discontinuing performance." (footnotes omitted)). *Cf.* McNeil v. McNeil, 798 A.2d 503, 509 (Del. 2002) ("Courts . . . flatly refuse to enforce provisions relieving a trustee of all liability. A trust in which there is no legally binding obligation on a trustee is a trust in name only . . . ." (citation omitted)).

307. *See, e.g.*, J D Heydon, *Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?*, *in* EQUITY IN COMMERCIAL LAW 185, 234 (Simone Degeling & James Edelman eds., 2005) ("It cannot be said that equity does not lay down prescriptive rules and leaves it to 'company law' to do so: the prescriptive duty to act in the best interests of the company is imposed on directors because of equity, not because of some aspect of 'company law' which is outside equity.").

308. In this Article, "equity" is used not in a historical sense, of a normative system distinct from "law," but in a broader substantive sense, *see, e.g.*, Manesh, *supra* note 275, at 425 ("[E]quity [is also referred to here] in the broader sense, meaning the power vested in all courts 'to do right and justice' by exercising judi-

vested with equitable power, which includes the duty to apply the law correctly, even if contrary to a simplistic reading of statutory text. At the federal level, the U.S. Constitution provides that "[t]he judicial Power shall extend to all Cases, in Law and Equity."[309] At the state level, particularly in Delaware, equitable jurisdiction enjoys similar constitutional protections.[310] Even if no *text* said that every court is required to do justice—and that every person is entitled to justice—this fact is self-evident. It is therefore an invalid, empty defense to simply mention that LLC statutes allow for the waiver of fiduciary duties. Reading the *whole* statute, and understanding what an LLC—or any other corporation—actually *is*, clarifies that at least a "core"[311] of fiduciary obligation always persists.

So, what *is* the practical meaning of the "elimination" of fiduciary duties owed to Delaware alternative corporations, or anyone else in like position? It means that certain actors, bound by certain duties, are better positioned to breach those duties with impunity. Most fiduciaries do not act unlawfully. Yet, certain legislative acts and court decisions afford them the "opportunity" to do so, if only they wanted, far more conveniently. To a large extent, some LLC managers can harm the corporation in multiple ways, and simply not be held accountable. For some fiduciaries, there *is* free lunch—which is not free at all, but comes at the expense of those in the position of most abject vulnerability.[312] This deviation of enforceable

cial discretion in how the law is interpreted and applied."); Smith, *supra* note 215 (analyzing equity from a modern law and economics perspective).

309. U.S. CONST. art. III, § 2, cl. 1. Federal case law also supports an expansive view of equity. *See, e.g.*, Johnson, *supra* note 119, at 709 n.41 (citing Supreme Court cases to that effect).

310. *See* DEL. CONST. art. IV, § 10 ("This court shall have all the jurisdiction and powers vested by the laws of this State in the Court of Chancery."); Du Pont v. Du Pont, 85 A.2d 724, 727–29 (Del. 1951) ("[T]he general equity jurisdiction of the Court of Chancery . . . is defined as all the general equity jurisdiction of the High Court of Chancery of Great Britain as it existed prior to the separation of the colonies . . . . [The Delaware Constitution] intended to establish . . . a tribunal to administer the remedies and principles of equity. . . . Its result is to establish by the Judiciary Article of the Constitution the irreducible minimum of the judiciary. It secures for the protection of the people an adequate judicial system and removes it from the vagaries of legislative whim."); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (stating, four years after the passage of Delaware's new General Corporation Law, that "inequitable action does not become permissible simply because it is legally possible"); *In re* Carlisle Etcetera LLC, 114 A.3d 592, 603–05 (Del. Ch. 2015) ("I cannot accept the contention that . . . LLCs . . . fall outside the domain of equity. . . . [W]hen . . . an entity [has] attributes that contracting parties cannot grant themselves by agreement, the entity is not purely contractual."); Johnson, *supra* note 119, at 702 ("The argument made here . . . contends that the Delaware General Assembly is constitutionally prohibited from preventing the judges of the Delaware Court of Chancery from applying fiduciary duties as those judges think best—whether or not a private agreement purports to eliminate such duties.").

311. Licht, *supra* note 302, at 179.

312. *See, e.g.*, de Fontenay, *supra* note 1, at 223 ("What precisely does it mean for a director to have no duty of loyalty whatsoever to shareholders or to the corporation? Taken literally, it would suggest that directors could simply gamble away

law from actual law (including equity) is not even economically efficient.[313]

In summary, certain areas of U.S. corporate law—which, in the substantive sense of the word, includes alternative corporations, such as LLCs—are now in a state similar to the late Middle Ages in England, as we find in Maitland's vivid tale of the development of equity.[314] It is unlikely that human nature is about to change;[315] corporate fiduciary law is an inherent, unwaivable part of the structure governing *all* corporations, however flexible they might otherwise be.

CONCLUSION

Participants in the corporate law community—judges, lawyers, businesspeople, scholars, and many others—grapple with a set of recurring questions. The ones about which corporate jurists think most often are those pertaining to modifiable, *dynamic* choices: "should multiple-class shares be permitted?" and "does a staggered board promote or weaken managers' compliance with their duties?" are common examples. At a more fundamental, *structural* level, the questions are "what is a corporation?" and "what is the corporation's purpose?" As this Article suggests, the most overarching question might be: "what is corporate law?"

As to the latter, modern scholars mainly attempt to frame corporate law in terms of *other* concepts or legal fields. The best example, of course, is the proclamation that corporate law is contract law, hallmark of the law and economics movement and its "nexus of contracts" theory. Others have countered by stating that corporate law "is property law, not contract law."[316] What *all* of these scholars have failed to consider is one possibility: corporate law is corporate law. Its unique structure, presenting its own set of practical issues, doctrines, and actors ("corporation," "shareholder,"

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the corporation's money, or use corporate property to advance the director's private business interests. Absent a duty of loyalty, charlatans could abuse the corporate form . . . .").

313. *See id.* ("[W]hile the law may nominally permit waivers of the duty of loyalty . . . , the courts are likely to intervene through other doctrines . . . . [T]his . . . would create substantial legal uncertainty in the interim, which, as we are so often told, is bad for business.").

314. F. W. MAITLAND, EQUITY, ALSO THE FORMS OF ACTION AT COMMON LAW 4–6 (1909) ("Very often the petitioner . . . complains that for some reason or another he can not get a remedy in the ordinary course of justice and yet he is entitled to a remedy. He is poor, . . . his adversary is rich and powerful, . . . or has by some trick or some accident acquired an advantage of which the ordinary courts with their formal procedure will not deprive him. . . . [O]wing to one thing and another such wrongs are not always redressed by courts of law.").

315. *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . .").

316. Hansmann & Kraakman, *supra* note 110, at 440.

"director"), is capable of generating highly beneficial economic and social outcomes, not achievable through any other framework.

This Article provides a first-of-its-kind, nuanced, and fully self-explanatory account of corporate law's structure and normative underpinnings. Corporate law brings to the table at least two concepts we find in no other field: the first, discussed in Section I.A above, is *corporate purpose*. Every corporation exists in order to achieve a certain purpose, which might be the lawful pursuit of profit, or any other, such as those of nonprofit corporations. The second concept, discussed in Section I.B above, is *corporate personhood*. Every corporation is a legal person, bearing its own rights, duties, identity, and characteristics, separate from any other entity, and (with few exceptions) possessing the same legal capacity as a natural person.

These two concepts, in turn, necessarily give rise to three additional groups of actors: stakeholders, residual claimants, and fiduciaries. As Section I.C above describes, stakeholders, or non-residual claimants, enjoy a superior normative framework upon which their claims rest: general, non-corporate law. Thanks to its inherently higher *information content*, general law provides far more specific and easily enforceable imperatives than corporate law, with its wide-open command to the corporation: "do whatever (to achieve your purpose)." Therefore, "corporate social responsibility" advocates should seek reform in general, not corporate, law. The corporation, like any other person, is required to meet all obligations under positive law. It cannot be subject to legal sanction for lawful behavior, even when some might view that behavior as subjectively undesirable.

Residual claimants (often known as "shareholders"), discussed in Section I.D above, in fact have *the opposite* of "primacy": their legal claim is fully a product of corporate law, and is completely subordinated to all stakeholders' claims. While residual claimants do not "own" the corporation or its assets, and are not directly owed duties by its fiduciaries, their unique situation makes their claims more than contractual. Share law is grounded in equity—no more, no less.

Those usually occupying the center stage of corporate law adjudication and scholarship—the corporation's fiduciaries, discussed in Section I.E above—do not owe direct duties either to shareholders or to stakeholders. Their duties run to the corporate person. By necessity, due to the extreme and unavoidable power and information asymmetries between the artificial person and its human representatives, the latter owe *fiduciary* duties to the corporation—nothing short of that. Fiduciaries are duty-bound to act in order to make the corporation achieve its purpose.

Finally, Part II above discusses three high-currency topics pervading today's corporate law: shareholder activism, corporations' constitutional rights in light of the *Citizens United* and *Hobby Lobby* decisions, and the rise of LLCs and other alternative corporations. In each case, the fundamental, unwaivable structure of corporate law provides a new, more well-grounded viewpoint from which to examine these issues.

As this Article proves, the present-day dichotomy of corporate law—the great debate between shareholderists and stakeholderists, each seeking to promote external values (economic and communitarian, respectively) within corporate law itself—does not, in fact, cohere with either positive law or normative analysis. It is possible for a corporation to act for profit without offending anyone else in any legally proscribed way. If the corporation *does* breach its obligations, positive law provides ample responses. At the same time, the corporation—an entirely separate person, with its own rights, duties, and traits—is not meant to operate "for" shareholders, and is not obliged to follow their desires. The rights shareholders and stakeholders possess are gained through (corporate or non-corporate) *law*.

One early case, touching upon four of the five building blocks discussed in this Article, paints a remarkably precise diagram of corporate law's structure:

> There is no legal privity, relation, or immediate connexion, between the holders of shares . . . and the directors . . . . The bank is a corporation and body politic, having a separate existence as a distinct person in law . . . . The very purpose of incorporation is, to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty, and perhaps . . . the utter impracticability, of such a number of persons acting together in their individual capacities. . . . [T]he directors are the appointees of the corporation, not of the individuals. . . . [Stockholders] are not the legal owners of the property . . . . Their rights and their powers are limited . . . . They are members of an organized body, and exercise such powers as the organization of the institution gives them. . . . [O]nly after [the corporation's] debts were paid . . . the stockholders would be entitled to receive any thing. . . . [S]hares . . . [are] a qualified and equitable interest . . . .[317]

The one building block not discussed in *Smith v. Hurd*[318] is that around which all the others may be arranged: the corporation's purpose. Yet, there is no reason to suggest that the court saw the for-profit corporation's purpose as altruistic; its remark on the corporation's "debts" implies that those obligations can be ascertained through positive law, and are not an open-ended guess. Furthermore, the court's mention of shareholders' "equitable" rights, in a decision which might otherwise seem critical of them, points to the nuanced structure of corporate law, and the importance of being attentive to *each* of its elements.

More than 170 years have passed since *Smith v. Hurd* was decided, but many members of the corporate law community still perpetuate the same

317. Smith v. Hurd, 53 Mass. (12 Met.) 371, 384–86 (1847).
318. *Id.*

misconceptions that opinion had elaborately rejected. The structure of corporate law allows us to achieve what would otherwise be "utterly impracticable." It is time to take corporate law seriously.

MANDATORY ARBITRATION AND THE BOUNDARIES OF CORPORATE LAW

ASAF RAZ*

ABSTRACT

A storm is brewing on the corporate law horizon. Several recent judicial developments, which this Article ties together for the first time, present the most refined opportunity yet for mandatory arbitration—today prevalent in consumer and employment contracts—to enter the corporate law sphere, shutting the courthouse doors before corporate entities and shareholders precisely where legal remedy is most needed. Yet, for this scenario to unfold, the Supreme Court would have to declare that corporate charters and bylaws are "contracts." Otherwise, restrictions on arbitration (including those recently enacted by Delaware) cannot be preempted by the Federal Arbitration Act.

As this Article innovatively explains, scholars have long resorted to inaccurate metaphors, such as "nexus of contracts," in the corporate context. If, however, we move away from legal realist conventions, embrace the idea that corporate law is a self-standing category within private law, and examine its distinctive properties—most importantly, its principled reliance on ex post judicial supervision over open-ended factual scenarios—we find that corporate law is nearly the structural opposite of contract law. This legal distinction also generates a set of powerful economic benefits. Existing scholarship has focused on procedural and doctrinal aspects, such as directors' power to amend corporate documents without shareholders' consent. This Article ties the arguments into an overarching theoretical framework, originally bringing together the literature on private law theory, law and economics, and corporate litigation.

Similar to the 1980s takeover wave, and recent debates surrounding corporations' constitutional rights and corporate purpose, the specter of mandatory arbitration offers an opportunity to take a fresh look at corporate law's theoretical foundations. The economic benefits and non-contractual, equity-based structure of corporate law are two sides of the same coin. To avoid both inefficiency and injustice, courts and scholars must recognize the implications of corporate law's distinct nature.

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INTRODUCTION

Corporate law is not contract law, and corporate charters and bylaws are not contracts. Influenced by American Legal Realism,[1] with its skepticism of legal concepts and categories,[2] scholars over the last several decades have been loosely employing a contract-centric terminology when discussing issues in corporate law.[3] As this Article demonstrates, those references have been, at most, a metaphor. In practice, both law and economics scholars,[4] and the Delaware courts, are taking corporate law for what it actually is: a distinct legal framework, having its own defining structure, and residing on the same level as contract, property, or tort in the hierarchy of private law.[5] Corporate law's unique characteristics, in turn, allow our economy, society, and technology to flourish, in a way no other legal framework can (or is meant to) achieve.[6]

As this Article explains for the first time, the "contract" metaphor—so far tamed by this more nuanced understanding—is now set on a course that

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[1] *See, e.g.*, Edward B. Rock, *Corporate Law Doctrine and the Legacy of American Legal Realism*, 163 U. PA. L. REV. 2019 (2015).

[2] *See, e.g.*, Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 820 (1935) ("[A legal] proposition . . . would be scientifically useful if [the legal concepts it uses] were defined in non-legal terms.").

[3] Prominent examples include Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 555-60 (1990) (discussing much of corporate law as consisting of "avoidable rules" and "changeable rules"); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302 (1983) ("An organization is the nexus of contracts, written and unwritten, among owners of factors of production and customers.").

[4] For a detailed analysis of the link between legal realism and modern law and economics, along with a suggestion as to how to better construe both, see Henry E. Smith, *Complexity and the Cathedral: Making Law and Economics More Calabresian*, 48 EUR. J.L. & ECON. 43 (2019).

[5] Importantly, these other frameworks (contract, property, and tort law) have already moved away from the more extreme form of legal realism. Today, much of the scholarship is devoted to the *legal* concepts that govern these fields (in a manner that also responds to economic and other extra-legal concerns). This change is largely taking place as part of the New Private Law movement. *See infra* notes 261-66 and accompanying text. This Article introduces the New Private Law approach into corporate law, where it has not been widely applied before.

[6] *See infra* Section II.B (explaining how corporate law facilitates innovation and entrepreneurship, by creating legal entities with human-like freedom of action, subject to very few contractual or legal constraints ex ante, and subject to broad judicial supervision ex post).

might lead it to fundamentally reshape American corporate law as we know it. Two recent developments—one, a judicial decision from the Supreme Court of Delaware;[7] the other, a case currently pending in federal court[8]—might operate in conjunction to bring about a dramatic development: sending corporate law into the "black hole"[9] of mandatory arbitration.

Provisions of this kind, today commonly found in consumer and employment contracts, shut the courthouse doors precisely in those situations where civil justice is most needed, and impose severe human and economic costs on our society and rule of law.[10] Corporate law, which relies on litigation even more heavily than other legal frameworks,[11] would functionally become a dead letter under a mandatory arbitration regime.[12] Yet, according to both the Federal Arbitration Act[13] (FAA) itself, and the United States Supreme Court, this scenario can only transpire if the federal courts find corporate charters and bylaws to be "contracts."[14] Ironically, the Realist-inspired imprecision that has given rise to such phrases as "nexus of contracts"[15] might put the brakes on the highly influential "corporate governance movement,"[16] advocated by the very same law and economics scholars who are using these phrases.

This Article makes two original contributions to the literature: first,

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[7] Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020).

[8] Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. filed Mar. 21, 2019).

[9] Cynthia Estlund, *The Black Hole of Mandatory Arbitration*, 96 N.C. L. REV. 679 (2018).

[10] *See, e.g.*, MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW (2013).

[11] *See infra* Sections II.B, II.C.

[12] *See, e.g.*, Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 626-40 (2016).

[13] 43 Stat. 883 (codified as amended at 9 U.S.C. §§ 1-16 (2020)).

[14] *See infra* note 21 and accompanying text.

[15] *E.g.* Fama & Jensen, *supra* note 3, at 302. The phrase "nexus of contracts" appears in over 1,600 works of corporate law literature. *See* LEXIS+, https://plus.lexis.com (last visited Apr. 2, 2021) (search for the term "nexus of contracts" within the category "Secondary Materials"; the search generates 1,670 results). As this Article explains, that usage does not support a judicial or other legal finding that corporate charters and bylaws are contracts. *See infra* Section II.C.

[16] *E.g.* Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359 *passim* (2016).

in Part I, it describes the current doctrinal situation—what *Salzberg* and *Johnson & Johnson* say, how they relate to one another, and how arbitration proponents might, in the near future, utilize these cases to try and introduce mandatory arbitration, first into federal securities law, then state corporate law. No previous academic work has analyzed *Johnson & Johnson* in depth; and, while *Salzberg* did attract much scholarly fanfare,[17] these works have focused on a different dimension—the boundary between corporate and securities law, and the practice of forum selection provisions (which send cases to one court, rather than another)—as opposed to this Article's emphasis on the more troubling prospect of mandatory arbitration, which aims to stifle *all* litigation on behalf of the affected corporations.[18]

This Article's second contribution is even more distinctive: so far, scholarship about corporate litigation has been carried out mostly apart from the literature on corporate theory (or "corporate anatomy"[19]). The former mainly discusses doctrinal and practical developments in the way corporate law is enforced, while the latter seeks to discern the legal and economic principles that make corporate law what it is. This Article, in Part II, ties the two areas

[17] *See* Dhruv Aggarwal, Albert H. Choi & Ofer Eldar, *Federal Forum Provisions and the Internal Affairs Doctrine*, 10 HARV. BUS. L. REV. 383 (2020) (empirically reviewing the effect of the Chancery Court's *Salzberg* decision on the share prices of corporations that have adopted federal forum provisions, and calling for the decision's reversal on these grounds and others); Joseph A. Grundfest, *The Limits of Delaware Corporate Law: Internal Affairs, Federal Forum Provisions, and* Sciabacucchi, 75 BUS. LAW. 1319 (2019) (criticizing the Chancery Court's *Salzberg* decision and calling for its reversal, based primarily on arguments in the state-vs.-federal law, or internal affairs, dimension); Michael Klausner, Jason Hegland, Carin LeVine & Jessica Shin, *State Section 11 Litigation in the Post-*Cyan *Environment (Despite* Sciabacucchi*)*, 75 BUS. LAW. 1769 (2020) (positively reviewing the Delaware Supreme Court's *Salzberg* decision, while arguing that litigation under the Securities Act of 1933 might continue in state courts despite the decision); Daniel B. Listwa & Bradley J. Polivka, *First Principles for Forum Provisions*, 2019 CARDOZO L. REV. DE NOVO 106 (arguing that the Chancery Court's *Salzberg* decision erred in its construction of the internal affairs doctrine, due to applying a principle of territoriality rather than comity); Mohsen Manesh, *The Contested Edges of Internal Affairs*, 87 TENN. L. REV. 251 (2020) (discussing the *Salzberg* case and other recent developments with the potential of fundamentally expanding or restricting the influence of state corporate law, particularly that of Delaware).

[18] *See, e.g.*, Aggarwal, Choi & Eldar, *supra* note 17, at 414-16; Grundfest, *supra* note 17, at 1341 ("Standard objections to arbitration, which include a lack of transparency and the loss of rights that are common in federal or state court, are meaningless when assessing [a federal forum provision] that directs federal claims to an open federal court where the Federal Rules of Civil Procedure and Federal Rules of Evidence apply." (footnote omitted)).

[19] *See, e.g.*, REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (3d ed. 2017).

together.

Achieving this synthesis is crucial, because the highly practical, litigation-vs.-arbitration controversy actually hinges on a theoretical question: is corporate law a branch of contract law, and by extension,[20] are corporate charters and bylaws contracts? According to both the FAA itself, and the U.S. Supreme Court, the FAA strictly applies to contractual, consent-based relationships, as opposed to those grounded in other legal frameworks.[21] If corporate law lies outside of contract law, then arbitration proponents' efforts should fail,[22] and corporate law may remain vital and enforceable.

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[20] This is a critical point: if corporate law is not contract law, then by definition, it is impossible for corporate charters and bylaws to be contracts. The reason is that "contract," just like "corporate charter," is a *legal* concept. Neither instrument can "pull itself by the bootstraps" and modify its own pre-existing nature. That nature is initially defined by law. *See, e.g.*, James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 279 n.91 (2015); Felipe Jiménez, *The Grounds of Arbitral Authority* 10-13 (July 22, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3657506. To determine if something is a contract or not, we must turn to the organic legal framework that gives rise to that instrument (which, in U.S. private law, is mostly state common law; this is also what the federal courts will have to rely on when considering the questions covered in this Article. *See infra* notes 126-27 and accompanying text). For charters and bylaws, that framework is corporate law, which—due to the reasons described in this Article—gives rise to something very different than "contracts," as they are defined by contract law. Since corporate law mandates that every corporation *must* have at least a charter, *see, e.g.*, DEL. CODE ANN. tit. 8, § 101(a) (2020), it is logically impossible for these documents to be "contracts," seemingly placing all corporations under the rule of contract law, which is precisely what corporate law differs from. People can still make contracts *in regard to* corporations (such as a share transfer agreement), just as they can make contracts for the sale of property, for the waiver of a right arising in tort, or for giving up their share under a will. This fact does not turn the *original* device—the corporate charter, deed of property, act of tort, or will—into a contract. If no contract was made, which is the default case, we are left with the non-contractual rights and duties, governed by corporate, property, tort, and inheritance law, respectively.

[21] *See* Federal Arbitration Act, 9 U.S.C. § 2 (2020) ("A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."). Similarly, the Supreme Court has repeatedly invoked "the fundamental principle that arbitration is a matter of contract," Rent-A-Center, W., Inc. v. Jackson, 561 U.S. 63, 67 (2010), *quoted in* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339 (2011).

[22] *See, e.g.*, Zachary D. Clopton & Verity Winship, *A Cooperative Federalism Approach to Shareholder Arbitration*, 128 YALE L.J.F. 169, 177 (2018) ("Under the FAA, arbitration agreements are presumptively valid, irrevocable, and enforceable. This presumption is triggered, however, only if corporate governing documents count as 'contracts' under the FAA.").

If, however, we take the "contract" metaphor at face value, presumably not much would be left[23] to stop the Supreme Court from giving fiduciaries the green light to self-exculpate through mandatory arbitration clauses—which is likely to occur in precisely those corporations that would most need the assistance of courts.[24] Considering that the total value of publicly-listed shares at U.S. stock exchanges, in 2020, was over $50 trillion,[25] it is hard to overstate what is hanging in the balance.

As this Article originally explains, the confusion between corporate and contract law—now on the verge of causing its greatest harm ever—is the result of a broader "low-visibility problem" that has been plaguing corporate law discourse for many decades. That problem exists on at least three levels. First, scholars often fail to treat corporate law *as law*,[26] that is, a jural discipline

[23] This Article takes seriously the Supreme Court's distinction between contracts and non-contracts for purposes of the FAA. Of course, one might again suggest a more "realist" theory: the conservative members of the Court believe civil litigation should be marginalized, and have found mandatory arbitration to be a convenient way to dispose of it. For a similar argument, see Pamela K. Bookman, *The Arbitration-Litigation Paradox*, 72 VAND. L. REV. 1119 (2019). Presumably, judges in FAA cases might define as "contract" anything they do not want people to be able to vindicate in court. To the extent it occurs, this problem can be separately addressed: primarily, we must do away with the idea that supporting private litigation, or opposing it, is a "liberal" or "conservative" matter. The enforcement of private law, through litigation, is (and can become more of) a bipartisan cause. *See, e.g.*, BRIAN T. FITZPATRICK, THE CONSERVATIVE CASE FOR CLASS ACTIONS (2019). Moreover, a functioning, enforceable private law is a condition for the existence of free markets and, indeed, free society. *See infra* notes 256-60 and accompanying text. Putting the political dimension aside for the moment, this Article provides an equally important part of the argument that should be made to the Court, when the issue of mandatory arbitration in corporate law comes before it.

[24] *See infra* note 204 and accompanying text.

[25] *See Total Market Value of U.S. Stock Market*, SIBLIUS RES., https://siblisresearch.com/data/us-stock-market-value (last visited Apr. 2, 2021) (stating that "[t]he total market capitalization of [the] U.S. stock market is [$50.8 trillion] [as of Dec. 31, 2020]"). This amount should be considered in addition to the value of shares issued by private, or not-publicly-listed, corporations. The latter are an increasingly important phenomenon. *See, e.g.*, Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 157 (2019) ("Over three hundred 'unicorn' startups have reached private valuations described as one billion dollars or more. . . . Our economy and society are increasingly dominated by companies that start in the proverbial garage or dorm room and, for a critical period, operate [as private companies]."). Both private and public corporations feature the same basic structure discussed in this Article, *see infra* Part II. That structure requires, among other things, ex post supervision by courts, and is incompatible with mandatory arbitration.

[26] *See, e.g.*, Bill Bratton, *Corporate Law as Law*, JOTWELL (Nov. 15, 2019) (reviewing DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN CORPORATE FIDUCIARY LAW (2018)), https://corp.jotwell.com/corporate-law-as-law (treating the possibility of

having its own internal structure, rules, and principles;[27] instead, corporate law is often studied as a predominantly economic[28] or political[29] matter.[30]

Second, even when scholars do think in legal terms, corporate law is often assumed to be merely part of some *other* discipline—mainly contract (this Article's focus), but also agency[31] or property law,[32] among others.[33]

"corporate law as law" with an air of surprise; also stating that, while "Kershaw is affirmatively . . . anti-realist," "I cannot join him in that").

[27] *See* Shyamkrishna Balganesh & Gideon Parchomovsky, *Structure and Value in the Common Law*, 163 U. PA. L. REV. 1241 (2015).

[28] *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991); Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's* q, 73 VAND. L. REV. 353 (2020) (surveying a wide range of recent works in that vein).

[29] *See, e.g.*, Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205 (2001) (suggesting that the prevalence of corporate litigation is a matter of political economy, through which Delaware preserves its status as the premier venue for incorporation). In contrast, this Article embraces a position much closer to KERSHAW, *supra* note 26: corporate law has its own substance, and practices such as corporate litigation are meant to protect the independent rights and expectations of real people, predating concepts such as "race to the bottom" or "race to the top." Corporate law's reliance on litigation is not a bug, but a feature.

[30] Corporate law is the only framework experiencing this problem at such magnitude. Other disciplines in private law, including property, tort, and contract itself, have long moved toward greater emphasis on legal concepts and unifying principles. *See, e.g.*, *infra* notes 261-66 and accompanying text. In fact, this move is also occurring in other areas of business law itself. *See, e.g.*, John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1231-32 (2014) ("I offer a broad perspective by suggesting . . . that the essence of investment funds and their regulation lies . . . in the nature of their organization. An investment fund . . . is an enterprise that holds investments in a particular way. . . . This pattern . . . has never been [previously] identified as a common feature of the various types of investment funds."). This Article brings a similarly broad perspective to corporate law.

[31] *See, e.g.*, J.B. Heaton, *Corporate Governance and the Cult of Agency*, 64 VILL. L. REV. 201, 207-14 & *passim* (2019) (surveying in detail the development of "agency" as a central term of art in corporate academic literature; also strongly criticizing that usage).

[32] *See, e.g.*, Robert Anderson IV, *A Property Theory of Corporate Law*, 2020 COLUM. BUS. L. REV. 1; Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 440 (2000) ("At its essential core, organizational law is property law, not contract law.").

[33] Some scholars, mainly on the stakeholderist (or "corporate social responsibility") side, often overlook the line separating corporate law from public law, or general regulation. *See,*

Third, although they sometimes accept that corporate law is a self-standing legal category, most scholars tend to overlook at least one of the defining building blocks that, together, make corporate law what it is: the corporation's purpose, separate personhood, duty to obey positive law, equitable obligations to residual claimants, and fiduciary duties owed to the entity.[34] These foundational elements are supplied by law, not contract;[35] and, as this Article describes, they give rise to unique economic and social benefits, not achievable through any other legal framework.[36] On the flipside, these properties of corporate law also require constant, ex post monitoring by courts of equity, through litigation—precisely what mandatory arbitration makes impossible.

To be certain, although the link between corporate litigation and corporate theory scholarship can be made much stronger, this Article joins a body of literature that has started making it. In a groundbreaking 2016 article,[37] Professor Ann Lipton dissects the problem of mandatory arbitration in corporate law, criticizing it from both descriptive (corporations are not contracts, so the FAA cannot apply to them)[38] and normative (mandatory arbitration would make corporate law largely unenforceable, leading to an unjustified impairment of shareholders' rights)[39] aspects. Professors James Cox and Jill Fisch have recently made similar arguments,[40] in the somewhat more benign[41] context of forum selection provisions. As the citations throughout this Article demonstrate, a number of other authors have turned their attention to this scholarly space.

While this Article builds upon these essential works, it also importantly adds to them. First, in the doctrinal dimension, this Article is the

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e.g., Sarah E. Light, *The Law of the Corporation as Environmental Law*, 71 STAN. L. REV. 137 (2019).

[34] *See* Asaf Raz, *A Purpose-Based Theory of Corporate Law*, 65 VILL. L. REV. 523 (2020).

[35] For example, regarding separate personhood, see KRAAKMAN ET AL., *supra* note 19, at 31 ("[L]egal personality [] clearly requires special rules of law.").

[36] *See infra* Section II.B.

[37] Lipton, *supra* note 12.

[38] *See id.* at 600-26.

[39] *See id.* at 626-40.

[40] Cox, *supra* note 20; Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373 (2018).

[41] *See supra* note 18 and accompanying text.

first to discuss and analyze several very recent developments—namely, the *Salzberg* and *Johnson & Johnson* cases[42]—which, if left unchecked, might soon turn mandatory arbitration in corporate law to a reality. Second, in the theoretical dimension, it offers an innovative account of corporate law's distinctive, and non-contractual, nature. Existing works[43] mainly discuss the topic through various *examples*, correctly illustrating how consent is lacking from the day-to-day workings of corporate law. These examples, however, are not tied into an overarching theory; they demonstrate that corporate law *is not* contract law, but they do not explain *why* that is so—what advantages we derive from corporate law's unique structure. They also do not fully discuss why corporate law cannot *become* more cognate with contract law, if courts or other lawmakers considered making it so. This Article provides that explanation in detail.[44]

Moreover, previous works have concentrated on various power and information asymmetries between shareholders and managers, which make "shareholder consent" to such litigation-limiting provisions an empty construct.[45] This Article expands the argument much further: the problem of mandatory arbitration in corporate law is not merely one of consent;[46] rather, it is a problem of *enforcement* and *power to act*. Even the most well-informed group of shareholders cannot absolve all present and future fiduciaries of a

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[42] *See supra* notes 7-8 and accompanying text.

[43] *See, e.g.*, sources cited *supra* notes 12, 40.

[44] Relatedly, this Article fills another important gap in existing literature: even when writing about the mandatory structure of corporate law, scholars often invoke the *language* of contract. *See, e.g.*, Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1822 (1989) ("[Even] the contractual view of the corporation offers strong reasons for placing significant limits on the freedom to opt out."). This usage can become highly problematic, because in the arbitration context, the Supreme Court makes an almost binary distinction between contracts and non-contracts: under the textualist approach, anything that is a "contract" might, presumably, fall within the scope of the FAA. *See, e.g.*, Lipton, *supra* note 12, at 636 n.301. This Article takes a step back, proving that corporate law is not contract law, and charters and bylaws are not contracts, full stop.

[45] *See, e.g.*, Cox, *supra* note 20, at 258-59, 262-72, 283-90; Fisch, *supra* note 40, at 382-99; Lipton, *supra* note 12, at 600-26.

[46] This point is becoming increasingly important, due to the rise of highly powerful institutional investors. *See, e.g.*, Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263 (2019) (arguing that the empowerment of institutional investors can make corporate law unnecessary). In fact, corporate law is very much alive. *See* Raz, *supra* note 34, at 528, 531. Even to the extent private actors have greater power vis-à-vis directors and officers, and so might presumably "consent" to mandatory arbitration, that "consent" should not, as a rule, be enforced, for the reasons explained here. *See infra* Sections II.B, II.C.

corporation from legal liability to the entity, over inherently unpredictable, long-term, open-ended scenarios (precisely what corporate law is designed to facilitate). The ideas of equity and ex post supervision are woven into the fabric of corporate law, just as much as the business judgment rule or asset partitioning.

This Article proceeds as follows: Part I provides a doctrinal and practical overview of the current and near-future state of affairs in corporate mandatory arbitration. Section I.A offers an introduction to both mandatory arbitration and corporate litigation, as they currently stand. Section I.B discusses the *Johnson & Johnson* case in detail, also explaining how it relates to the recent *Salzberg* decision. Section I.C describes the route through which *Johnson & Johnson*, combined with *Salzberg*, might turn mandatory arbitration into a reality, first in the securities arena, then in state corporate law.

Part II turns to the theoretical argument. Because any inquiry into mandatory arbitration hinges on the question of whether corporate law is "contractual" in nature, that Part provides the answer: an unambiguous "no." Section II.A discusses the root problem—many scholars' and policymakers' ongoing refusal to recognize corporate law as a self-standing legal framework, and to study its unique nature. Section II.B goes to the heart of the argument: if not contract, what *is* corporate law, and what economic and other benefits do we derive from its distinctive *legal* structure? Section II.C addresses the way in which the phrase "contract" is used in both Delaware case law and corporate academic literature; it explains why looking at that word in isolation ignores a broader, more nuanced idea of corporate law, which both of these bodies of text are conveying.

Similar to the 1980s takeover wave,[47] the discussion surrounding corporations' constitutional rights over the last decade,[48] and the recent reinvigoration of the corporate purpose debate[49]—each bringing corporate

[47] *See, e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 263 (1992) ("The 1980s were turbulent years for corporation law. . . . [In 1977,] [n]o one realized . . . that . . . the secure ground upon which the accepted suppositions of corporation law had been premised would [soon] break apart . . . .").

[48] *See, e.g.*, Elizabeth Pollman, *Wrong Turns with Corporate Rights*, 98 B.U. L. REV. ONLINE 44, 44 n.1 (2018) (citing a wide range of recent scholarly works on the topic).

[49] *See, e.g.*, Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 100 TEX. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561164; Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, 46 J. CORP. L. 345 (2021) (surveying and responding to the recent flux of literature on the topic); Raz, *supra* note 34.

theory and corporate practice together in unforeseen ways—this Article turns the specter of mandatory arbitration from a threat to a scholarly opportunity. It is time to consider what corporate law does, and how it does it.[50] Pulling corporate law away from the more extreme form of legal realism would preserve its very existence, preventing it from being overrun by mandatory arbitration. As importantly, it would bring corporate literature in line with broader private law scholarship, and provide an answer to what is perhaps the most fundamental question in the field: why do we have corporate law in the first place—and why should we defend its continued presence, separate from any other framework, most pressingly, contract.

I. THE NEW ROAD TO MANDATORY ARBITRATION IN CORPORATE LAW

A. *The Present Landscape of Mandatory Arbitration and Corporate Litigation*

> [T]here can be no injury, but there must be a remedy in all or some of them; and therefore I will never determine that frauds of this kind are out of the reach of courts of law or equity, for an intolerable grievance would follow from such a determination.[51]

Before this Article delves into the issue of mandatory arbitration in corporate law, the current Section asks more generally: what are the pathologies of mandatory arbitration in the United States, and what is corporate litigation—which has so far remained outside of the mandatory arbitration sphere—doing in the meantime for our economy and civil justice system?

To start with, there is not much wrong with arbitration *per se*.[52] In

[50] *Cf.* Henry E. Smith, *The Persistence of System in Property Law*, 163 U. PA. L. REV. 2055, 2065 (2015) ("It is time to consider what property does, and how it does it.").

[51] Charitable Corp. v. Sutton (1742) 26 Eng. Rep. 642, 645; 2 Atk. 400, 406 (Eng.).

[52] As the discussion in this Section shows, the U.S. mandatory arbitration system bears little relation to other forms of arbitration, geared toward good faith dispute resolution and the provision of justice to deserving parties. That is generally the case, for example, in the field of international investment arbitration, as well as arbitration between power-symmetrical parties (the FAA's original subject matter), both of which are outside the scope of this Article. For a nuanced discussion of ways in which the U.S. mandatory arbitration system crosses the line from a dispute resolution device to a justice-impeding one, see Stephen J. Ware, *The Centrist Case Against Current (Conservative) Arbitration Law*, 68 FLA. L. REV. 1227 (2016).

current U.S. practice, however, "arbitration clauses" cover a wide range of provisions, often having nothing to do with arbitration as a method of dispute *resolution*, and everything to do with dispute *elimination* and *obfuscation*. These clauses are usually formulated by the party enjoying superior power and information, and are inserted, on a "take it or leave it" basis, into contracts of adhesion—mainly consumer and employment agreements, from mobile phone contracts[53] to those governing the hiring of law firm associates and partners.[54] The problem with the American version of mandatory arbitration, then, is rooted not in the concept of arbitration, but in the extremely simplistic way the Supreme Court requires that arbitration agreements be enforced "according to their terms."[55]

Although a plain reading of the FAA[56] instructs us that arbitration provisions "shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity* for the revocation of any contract,"[57] in practice, the Court has repeatedly failed to acknowledge almost any "such grounds." Instead, it has aggressively expanded the FAA's reach, even in cases where contract law or equity *do* require the non-enforcement of an arbitration provision,[58] and even where the contents of the arbitration clause negate any possibility of an "effective vindication"[59] of the legal rights at issue.

Such clauses might state, for example, that the weaker party "waives" all rights to bring any class action—although arbitration is fully compatible with class proceedings,[60] and despite the fact that it is entirely impossible to "arbitrate" certain claims on a non-class basis.[61] An arbitration clause can

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[53] *See, e.g.*, AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 336 (2011).

[54] *See, e.g.*, *infra* note 63.

[55] CompuCredit Corp. v. Greenwood, 565 U.S. 95, 98 (2012).

[56] Federal Arbitration Act, 43 Stat. 883 (codified as amended at 9 U.S.C. §§ 1-16 (2020)).

[57] *Id.* § 2 (emphasis added).

[58] *See, e.g.*, *AT&T Mobility v. Concepcion*, 563 U.S. at 352 (nullifying state contract law rule against certain unconscionable arbitration provisions).

[59] Am. Express Co. v. Italian Colors Rest., 570 U.S. 228 *passim* (2013).

[60] *See, e.g.*, *Supplementary Rules for Class Arbitrations*, AM. ARBITRATION ASS'N (Oct. 8, 2003), https://adr.org/sites/default/files/document_repository/Supplementary%20Rules%20for%20Class%20Arbitrations.pdf.

[61] *See, e.g.*, *AT&T Mobility v. Concepcion*, 563 U.S. at 365 (Breyer, J., dissenting) ("[A]greements that forbid the consolidation of claims can lead small-dollar claimants to abandon their claims rather than to litigate. . . . What rational lawyer would have signed on

purport to cover an unlimited range of future disputes in which the stronger party might be involved, even if they have nothing to do with, and could not be contemplated at the time of, the original contract where the arbitration mandate appears.[62] Even more extremely, an arbitration provision might declare that the arbitrator must defer to the very action being challenged in arbitration—thus creating what is known as "the firm always wins" clause.[63]

Some of the most basic tenets of law—namely, the principle that no one may be a judge in one's own case[64]—are thus being subverted by the U.S. system of mandatory arbitration. Unsurprisingly, this results in less people seeking to enforce their rights in the first place,[65] and deformation of justice in many of the cases that *are* filed.[66] In economic terms, the more justice-impeding the arbitration clause it can draft, the more wealth a party can unilaterally shift to itself. The gross inequities generated by mandatory arbitration's overreach have been studied extensively by scholars of civil procedure, constitutional law, and contract law.[67] This is far from purely a

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to represent the Concepcions in litigation for the possibility of fees stemming from a $30.22 claim?").

[62] *See* David Horton, *Infinite Arbitration Clauses*, 168 U. PA. L. REV. 633 (2020).

[63] *See* Respondent's Brief in Opposition at 7, Winston & Strawn LLP v. Ramos, No. 18-1437 (July 31, 2019), https://www.supremecourt.gov/DocketPDF/18/18-1437/109930/20190731162449651_18-1437_BIO.pdf (quoting the contents of a "firm always wins" arbitration clause from a law firm partnership agreement; the clause stated that "[t]he panel of arbitrators shall have no . . . authority to substitute its judgment for, or otherwise override the determinations of, the Partnership, or the Executive Committee or officers authorized to act in its behalf, with respect to any determination made or action committed to by such parties"). The law firm's petition for certiorari has been denied, after the parties' briefs and many amicus briefs were filed. *See Docket for 18-1437*, U.S. SUP. CT., https://www.supremecourt.gov/docket/docketfiles/html/public/18-1437.html (last visited Apr. 2, 2021). Yet, the very existence of such provisions (which remain, at least plausibly, valid in states where no judicial precedent has been reached to the contrary) highlights the pathologies of the U.S. mandatory arbitration system.

[64] *See, e.g.*, JOHN V. ORTH, DUE PROCESS OF LAW: A BRIEF HISTORY 15-32 (2003).

[65] *See, e.g.*, Estlund, *supra* note 9; Samuel Issacharoff & Florencia Marotta-Wurgler, *The Hollowed Out Common Law*, 67 U.C.L.A. L. REV. 600, 632-35 (2020); Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2812 (2015) ("Despite the heralding of arbitration as a speedy and effective alternative to courts, the mass production of arbitration clauses has not resulted in 'mass arbitrations.' Instead, the number of documented consumer arbitrations is startlingly small." (footnote omitted)).

[66] *See, e.g.*, RADIN, *supra* note 10.

[67] *See, e.g.*, Michelle L. Caton, *Form over Fairness: How the Supreme Court's Misreading of the Federal Arbitration Act Has Left Consumers in a Lurch*, 21 GEO. MASON L. REV. 497 (2014);

matter of legal doctrine: in a well-regarded 2013 book, Professor Margaret Jane Radin documents the human costs of mandatory arbitration clauses in the U.S., along with other, similarly self-exculpatory terms in standard-form contracts.[68]

To make things even worse, courts and legislatures (particularly at the state level) cannot do much about this. Once an arbitration provision has been placed in a contract, extremely little room is left for equitable, ex post review—possibly reshaping, limiting, or revoking arbitration in a specific case—to preserve any degree of justice-making. That is because, in a line of cases, epitomized by such decisions as *AT&T Mobility LLC v. Concepcion*,[69] the Supreme Court has held that almost no state law may interfere with any arbitration clause; state laws that do so are preempted by the FAA.[70]

As a result, if corporate charters and bylaws, at some point in the future, are found to come under the FAA's ambit, then presumably neither Delaware,[71] nor any other state of incorporation, may regulate what corporate directors and officers put into those documents, as long as they frame these provisions as "arbitration clauses." Contrary to the (justified) wishes of some scholars, the structure of U.S. arbitration law currently makes it impossible to ensure that cases will be heard by a "credible arbitral institution,"[72] or that a process of "interpretation"[73] by courts, limiting arbitration to "reasonable and

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Estlund, *supra* note 9; Arthur R. Miller, *Simplified Pleading, Meaningful Days in Court, and Trials on the Merits: Reflections on the Deformation of Federal Procedure*, 88 N.Y.U. L. REV. 286, 322-31 (2013); Resnik, *supra* note 65.

[68] RADIN, *supra* note 10.

[69] 563 U.S. 333 (2011).

[70] *See, e.g.*, *id.* at 352 ("Because it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' . . . California's *Discover Bank* rule [(prohibiting class action waivers in certain contracts)] is pre-empted by the FAA.") (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

[71] Delaware law does prohibit the inclusion of mandatory arbitration clauses in corporate charters and bylaws. *See* DEL. CODE ANN. tit. 8, § 115 (2020). As the Delaware legislature explained, "Section 115 . . . invalidates . . . a provision selecting the courts in a different State, or an arbitral forum, if it would preclude litigating [internal corporate] claims in the Delaware courts." S.B. 75, 148th Gen. Assemb., synopsis § 5 (Del. 2015) (enacted), https://legis.delaware.gov/json/BillDetail/GetPdfDocument?fileAttachmentId=51221.

[72] Andrew K. Jennings, *Firm Value and Intracorporate Arbitration*, 38 REV. LITIG. 1 *passim* (2018).

[73] Megan Wischmeier Shaner, *Interpreting Organizational Contracts and the Private Ordering of Public Company Governance*, 60 WM. & MARY L. REV. 985 *passim* (2019).

equitable"[74] provisions, will take place.

Despite all this, two borders have not been crossed. First, even while expanding the reach of anything bearing the title "arbitration clause," the Supreme Court continues to impose one overarching limitation: that clause must be part of a *contract*, not some other legal document.[75] Second (and closely related), mandatory arbitration has not become part of the corporate law landscape. In fact, no Supreme Court case has held corporate charters and bylaws to be "contracts" under the FAA. As this Article proves, these documents truly are not, cannot, and have never been contracts, under any form of doctrinal, historical, linguistic, or economic analysis.[76]

Accordingly, corporate law remains one of the more well-functioning areas of American law.[77] Directors, officers, and other actors bound by the norms of corporate law continue to be subject to the jurisdiction of regular courts, most importantly, those in Delaware.[78] "[T]he Delaware courts determine questions of liability in the most significant corporate law cases, [and] provide instruction on best practices for the directors of publicly held corporations."[79] This dual function—the corporate law court as a provider of both remedy and guidance—is recognized even by those scholars who most strongly advocate a wide breadth for the business judgment rule, and who stress the significance of "norms," as opposed to "law," in shaping the day-to-day

[74] *Id.* at 996. The exceptionally broad reach of federal arbitration law, and its interference with state law, present a uniquely problematic form of "ex ante corporate governance," not encountered in previous corporate governance debates (such as those over poison pills, staggered boards, forum selection clauses, and so on). The Supreme Court's arbitration jurisprudence makes it much more difficult to remedy wrongs through ex post, equitable intervention. That form of remedy is the traditional province of the courts—and a solution often invoked by scholars to address the various problems of private ordering in the corporate context. *See, e.g.*, George S. Geis, *Ex-Ante Corporate Governance*, 41 J. CORP. L. 609, 643-44 (2016); *infra* note 177.

[75] *See supra* note 21.

[76] *See infra* Part II.

[77] *See, e.g.*, Jill E. Fisch, *Leave it to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731 (2013).

[78] For a detailed discussion of recent cases where corporate law actors were held accountable in the Delaware courts, see Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623 (2017).

[79] David Skeel, *The Bylaw Puzzle in Delaware Corporate Law*, 72 BUS. LAW. 1, 23-24 (2016).

behavior of corporate actors.[80] The rise of powerful activist shareholders—pulling us away from the "Berle and Means" era,[81] characterized by strong separation of ownership and control—does not detract from the need for effective corporate litigation; instead, it *relies* on it.[82]

In one derivative action case, 2012's *Americas Mining Corporation v. Theriault*,[83] the Delaware courts have successfully remedied a fiduciary breach by a controlling shareholder, in the amount of $2.031 billion.[84] *Americas Mining* was a particularly fruitful exercise in corporate law enforcement, but the Delaware courts routinely grant remedies, and approve settlements, in the tens or hundreds of millions of dollars;[85] they do not shy away from denying motions to dismiss, even in cases that involve well-known, well-connected entities and businesspeople.[86]

As Section II.B below explains, the open-endedness of corporate

[80] *See, e.g.*, Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1661-63, 1686-89 (2001) (discussing situations where, despite the article's general thesis, corporate litigation remains necessary and beneficial); *see also* Lawrence A. Hamermesh, *A Babe in the Woods: An Essay on* Kirby Lumber *and the Evolution of Corporate Law*, 45 DEL. J. CORP. L. 125, 138 (2020) ("Skepticism about the limits of shareholder litigation . . . is not the same as implacable opposition to such litigation. In Delaware's system of corporate law, representative stockholder plaintiffs, and their lawyers, are a bulwark against misappropriation and electoral manipulation by self-interested directors, officers, and controlling stockholders, and are therefore a critical promoter of efficient, wealth-creating corporate governance.").

[81] *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[82] *See, e.g.*, Fisch, *supra* note 77, at 780 ("Today's corporation bears little resemblance to [the Berle and Means] model. . . . [I]nstitutional intermediaries own an ever-increasing majority of publicly traded equities and exercise the traditional shareholder powers such as the right to vote *and the right to sue*." (emphasis added)). This point is further illustrated *infra* note 87: if shareholders could not sue to repeal the inequitable poison pill, it is not clear how they could meaningfully exercise their voting rights. Without well-functioning courts of equity, there could be no effective shareholder activism to begin with.

[83] 51 A.3d 1213 (Del. 2012).

[84] *See id.* at 1218.

[85] *See, e.g.*, Friedlander, *supra* note 78.

[86] *See, e.g.*, *In re* Dell Techs. Inc. Class V Stockholders Litig., Consol. C.A. No. 2018-0816-JTL, 2020 Del. Ch. LEXIS 211 (Del. Ch. June 11, 2020) (denying motion to dismiss a complaint against Michael Dell and other defendants, following alleged non-compliance with the requirements set forth in Delaware law, in the course of a $40.5 billion share conversion transaction).

existence, where almost no legal constraints are imposed on the corporation ex ante, inevitably leads to a wide range of ever-changing factual scenarios. The Delaware courts—as opposed to "private ordering," or any other mechanism—are the ones who approve or reject, on an equitable, case-by-case basis, the numerous legal devices that corporations, their fiduciaries, and their legal counsel come up with.[87]

While corporate litigation is not perfect, of course, it is better than no litigation (that is, making corporate law unenforceable). Occasionally, non-meritorious litigation practices emerge from the plaintiff side, but the Delaware courts are well-versed in weeding them out.[88] Accordingly, leading corporate litigation scholars agree that litigation is an important, beneficial mechanism to enforce the substantive norms of corporate law;[89] while both meritorious and non-meritorious claims exist, as in any other field of law, no scholar seriously suggests eliminating *all* corporate litigation[90]—the equivalent of a 100% dismissal rate, whether the lawsuit is justified or not.

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[87] A perfect example is the poison pill. In 1985, the Delaware Supreme Court has accepted the original form of the poison pill as an anti-hostile-takeover device. *See* Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985). Yet, this ex ante grant of power does not mean that *any* use of a poison pill, even inequitably or contrary to the principles of corporate law, is permissible ex post. In 1998, the same court struck down a recent innovation—the "no-hand" poison pill, designed to be so irredeemable that not even a whole new board of directors could repeal it. *See* Quickturn Design Sys. v. Shapiro, 721 A.2d 1281 (Del. 1998).

[88] *See, e.g.*, *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016) (responding to the practice of "disclosure settlements"—ones leading to the payment of attorneys' fees while providing little additional value to the represented class of shareholders—by establishing a rule that requires the court not to approve a settlement, unless it clearly provides such value).

[89] *See, e.g.*, David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201, 266-67 (2015) (stating that "there is substantial evidence that at least a subset of existing class actions are meritorious and value enhancing, [and] that top firms and institutional lead plaintiffs, particularly public-pension funds, correlate with better outcomes for shareholders"; citing multiple sources to that effect).

[90] *See, e.g.*, Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015) (characterizing a specific troubling practice—settlements for supplemental disclosure and attorneys' fees, *see supra* note 88—while not implicating other, more meritorious litigation practices); Sean J. Griffith & Dorothy S. Lund, *A Mission Statement for Mutual Funds in Shareholder Litigation*, 87 U. CHI. L. REV. 1149 (2020) (discussing many benefits generated by shareholder litigation, and the manner in which mutual fund managers can be encouraged to bring more meritorious cases); Webber, *supra* note 89, at 267 ("An optimal reform to shareholder litigation would offer flexibility and nuance, allowing preservation of meritorious, value-enhancing actions . . . .").

Recently, however, even this final fortress—corporate law, enforceable in court—has come under clear and present danger, as Sections I.B and I.C below explain in detail.

B. *The* Johnson & Johnson *and* Salzberg *Cases: A New Roadmap for Mandatory Arbitration in Corporate Law*

On March 21, 2019, a relatively little-noticed case[91] was filed in the United States District Court for the District of New Jersey. That case, *Doris Behr 2012 Irrevocable Trust v. Johnson & Johnson*,[92] involves a unique procedural situation: a *shareholder* proposing the adoption of a mandatory arbitration clause in a corporation's bylaws. This fact makes the success of the arbitration proposal less likely in this specific case,[93] but that is not the most pertinent issue. More importantly, the arguments raised in *Johnson & Johnson* illustrate how, in the near future, when corporate *directors* start making such proposals, they will enjoy the most potent chance yet for mandatory arbitration to expand into the corporate law realm.

The *Johnson & Johnson* case has two features that are likely to be replicated in the near future, by directors aiming to impose mandatory arbitration on their corporations (and to secure the judicial precedents that will enable them to do so). First, the case directly deals with limits on the litigation of federal *securities* claims, rather than internal affairs, state law corporate claims. Arbitration proponents are likely to try ushering mandatory arbitration through the securities law door first, relying on the Delaware Supreme Court's

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[91] This Article is the first scholarly work to analyze the *Johnson & Johnson* case. The case received some coverage in other circles. *See, e.g.*, Cydney Posner, *Mandatory Arbitration Shareholder Proposal Goes to Court—As Chair Clayton Suggested*, COOLEY PUBCO (Mar. 25, 2019), https://cooleypubco.com/2019/03/25/mandatory-arbitration-shareholder-proposal-complaint. In early 2019, a group of 26 law professors have signed a white paper discussing the Johnson & Johnson shareholder proposal, predating the court case (and focusing on the internal affairs, corporate-vs.-securities dimension, which became less salient following the 2020 *Salzberg* decision). *See* Jacob Hale Russell, *Mandatory Securities Arbitration's Impermissibility Under State Corporate Law: An Analysis of the Johnson & Johnson Shareholder Proposal* (Rock Ctr. for Corp. Governance Working Paper Series No. 237, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3332853.

[92] No. 3:19-cv-8828 (D.N.J. filed Mar. 21, 2019). The complaint in this case was amended twice, following the Delaware Supreme Court's *Salzberg* decision and other developments, discussed below. Second Amended Complaint, Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. Oct. 20, 2020), https://perma.cc/7PYK-7WQD [hereinafter *Johnson & Johnson* Complaint].

[93] *See infra* text accompanying notes 157-62.

recent *Salzberg* decision,[94] discussed shortly below. While mandatory arbitration in securities law is bad enough, it might easily spread from there to state corporate law, as well.[95]

Second, the arbitration proponent in *Johnson & Johnson* has adopted a tactic, also likely to be followed by pro-arbitration directors, which ignores or attempts to sneak through the backdoor[96] the more important question in this debate: are corporate charters and bylaws "contracts," at least for purposes of the FAA?[97] If the federal courts correctly find (as they have before)[98] that these documents are not contracts, federal arbitration law cannot apply to them. If the courts fail to do so, however, the floodgates are likely to open for mandatory arbitration in both securities and corporate law.[99]

Under the combined effect of legal realism's disdain for categories,[100] and a misreading of some cases and scholarly works,[101] arbitration proponents would like this issue to either "slip under the radar," or be incorrectly answered. This Article puts the question squarely on the table, and cogently answers it. While *Johnson & Johnson* and *Salzberg* provide a boilerplate for arbitration proponents' arguments in the near future, they also provide the roadmap for rejecting them.

Johnson & Johnson was filed by Hal Scott, professor emeritus at Harvard Law School,[102] who is engaged in an academic and public campaign

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[94] Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020).

[95] *See infra* Section I.C.

[96] *See Johnson & Johnson* Complaint, *supra* note 92, at 5, 7, 12 (referring five times to corporate bylaws using the word "agreement," or its inflections, without any substantive discussion or attempt to support that claim).

[97] *See supra* note 21 (discussing the requirement that a "contract" be present for the FAA to apply).

[98] *See* Kirleis v. Dickie, McCamey & Chilcote, P.C., 560 F.3d 156 (3d Cir. 2009) (denying a corporate defendant's motion to compel arbitration, on the grounds that the plaintiff-shareholder never consented, in the contract law sense, to an arbitration clause in the corporation's bylaws).

[99] *See infra* Section I.C.

[100] *See, e.g.*, *supra* note 2 and accompanying text.

[101] *See infra* Section II.C.

[102] *See* Hal S. Scott, HARVARD LAW SCH., https://hls.harvard.edu/faculty/directory/10781/Scott (last visited Apr. 2, 2021). The *Johnson & Johnson* complaint was filed by Scott both in his personal name, and as trustee of the Doris Behr 2012 Irrevocable Trust, a Massachusetts common law trust, in which

against the practice of securities litigation.[103] In November 2018, somewhat ironically, Scott adopted a strategy most often employed by shareholder rights activists:[104] he made a shareholder proposal, and sought to have it voted on at the 2019 annual shareholder meeting of Johnson & Johnson, a New Jersey corporation.[105] Shareholders are entitled to do so under the SEC's Rule 14a-8,[106] but a corporation may refuse to include a proposal in its proxy materials, if any one of "few specific circumstances"[107] are met. Among those circumstances, the proposal might, "if implemented, cause the company to violate any state, federal, or foreign law to which it is subject."[108]

Scott's proxy submission was framed as a precatory proposal,[109] stating, "[t]he shareholders of Johnson & Johnson request the Board of Directors take all practicable steps to adopt a mandatory arbitration bylaw [providing as follows]."[110] In Scott's proposal, the bylaw would require "disputes between a stockholder and the Corporation and/or its directors, officers or controlling persons relating to claims under federal securities laws in connection with the

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capacity he owns 1,050 shares of Johnson & Johnson. *See Johnson & Johnson* Complaint, *supra* note 92, at 2, 6.

[103] *See, e.g.*, Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1188 (2013); Hal S. Scott, *The SEC's Misguided Attack on Shareholder Arbitration*, WALL ST. J. (Feb. 21, 2019), https://www.wsj.com/articles/the-secs-misguided-attack-on-shareholder-arbitration-11550794645.

[104] Scott is operating as what Professors Yaron Nili and Kobi Kastiel have termed a "corporate gadfly"—an individual shareholder, owning a relatively small number of shares, but potentially wielding large influence on corporate affairs by making various shareholder proposals. *See* Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3520214.

[105] *See* Johnson & Johnson Complaint, *supra* note 92, at 2, 4.

[106] 17 C.F.R. § 240.14a-8 (2020).

[107] *Id.*

[108] *Id.* § 240.14a-8(i)(2).

[109] A precatory shareholder proposal is an "advice" to the corporation or its directors, rather than a binding requirement. *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 846 (2005) ("[Precatory resolutions] are not binding: under state corporate law, directors have discretion whether to follow precatory proposals . . . , and directors' freedom to disregard such resolutions is protected under the business judgment rule.").

[110] *Johnson & Johnson* Complaint, *supra* note 92, at 4.

purchase or sale of any securities issued by the Corporation to be exclusively and finally settled by arbitration."[111] If adopted, Scott's proposed bylaw would mandate "that any disputes subject to arbitration may not be brought as a class and may not be consolidated or joined."[112]

Scott's proposal also included a "supporting statement," where things get even more intriguing. Among other contentions, that statement raises a patently false assertion: that "[t]he United States is the only developed country in which stockholders of public companies can form a class and sue their own company for violations of securities laws."[113] In reality, many developed countries have securities class actions; over the last few years, numerous European countries even saw an increase in certain kinds of collective shareholder litigation.[114] Recoveries for the class in such actions went as high as US$1.5 billion.[115]

Shortly thereafter, Johnson & Johnson rejected Scott's demand to include his proposal in the corporation's 2019 proxy materials, and sought a no-action letter from the SEC, affirming the legality of this decision.[116] In the back-and-forth of letters between the corporation, the SEC, and Scott, leading to the issuance of the no-action letter, Johnson & Johnson reasoned that a mandatory arbitration clause would, among other things, "violate New Jersey state [corporate] law."[117] The corporation based this argument on the Delaware Chancery Court's *Salzberg* decision,[118] but also on other, directly arbitration-

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[111] *Id.*

[112] *Id.* at 5.

[113] *Id.*

[114] *See Laying Down the Law: Europe Is Seeing More Collective Lawsuits from Shareholders*, ECONOMIST (Dec. 7, 2017), https://www.economist.com/finance-and-economics/2017/12/07/europe-is-seeing-more-collective-lawsuits-from-shareholders.

[115] *See The Top 25 Non-North American Settlements*, INSTITUTIONAL S'HOLDER SERVS. 2, 4 (2020), https://www.issgovernance.com/file/publications/ISS-SCAS-The-Top-25-Non-North-America-Settlements.pdf (providing information on the 2018 Netherlands case of Ageas SA/NV (f/k/a Fortis S.A./N.V. & Fortis N.V.), which settled for said amount; also providing information on high-recovery cases from several other countries).

[116] *See Johnson & Johnson* Complaint, *supra* note 92, at 6.

[117] *Id.* at 8 (emphasis omitted).

[118] Sciabacucchi v. Salzberg, No. 2017-0931-JTL, 2018 Del. Ch. LEXIS 578 (Del. Ch. Dec. 19, 2018). For discussion of the case, see *infra* text accompanying notes 135-46. Note that "Delaware law is significant here because . . . New Jersey courts frequently look for guidance [from Delaware] on corporate law issues absent controlling New Jersey authority." Memorandum of Law of Amicus Curiae Attorney General of the State of New Jersey at 7,

related authorities, such as *Kirleis v. Dickie, McCamey & Chilcote, P.C.*[119] In his responsive correspondence (and later, in the complaint countering the corporation's and SEC's positions), Scott raised several arguments centered on the U.S. Supreme Court's interpretation of the FAA.[120]

On February 11, 2019, the SEC issued the no-action letter requested by Johnson & Johnson,[121] thus blocking the arbitration proposal's way to the 2019 annual meeting. In response, Scott filed his action in the federal New Jersey District Court.[122] The complaint consists of a single count of action, for "violation of federal securities law,"[123] arguing that the proposed bylaw is not illegal under New Jersey corporate law, and even if it were, the state law is preempted by the FAA. Thus, Johnson & Johnson presumably acted unlawfully when it excluded Scott's proposal under Rule 14a-8(i)(2), since implementing the proposal would not cause the corporation "to violate any state, federal, or foreign law."[124]

The questions directly facing the court, therefore, are whether inserting a securities law mandatory arbitration clause into a corporation's bylaws conforms with New Jersey corporate law, and by extension,[125] Delaware corporate law; and, if such a clause is enacted, are the bylaws a "contract" to which the FAA, and the U.S. Supreme Court's arbitration precedents, apply.

Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. Aug. 27, 2019), https://perma.cc/W6DA-8EQC.

[119] 560 F.3d 156 (3d Cir. 2009) (denying a corporate defendant's motion to compel arbitration, on the grounds that the plaintiff-shareholder never consented, in the contract law sense, to an arbitration clause in the corporation's bylaws).

[120] *See Johnson & Johnson* Complaint, *supra* note 92, at 7. The main FAA cases relied upon by Scott, in response to Johnson & Johnson's and the SEC's letters, are *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), and *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612 (2018).

[121] Letter from Jacqueline Kaufman, Att'y-Adviser, SEC, to Johnson & Johnson (Feb. 11, 2019), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/dorisbehrjohnson021119-14a8.pdf.

[122] *See supra* note 92. The complaint cited *id.* is the second amended complaint filed by Scott, but his substantive arguments have remained nearly identical throughout his various complaints, except to the extent discussed in this Section, following the Delaware Supreme Court's *Salzberg* decision.

[123] *Johnson & Johnson* Complaint, *supra* note 92, at 12.

[124] 17 C.F.R. § 240.14a-8(i)(2) (2020).

[125] *See supra* note 118.

These are questions of state law: under the *Erie* doctrine,[126] federal courts adjudicating this issue—in *Johnson & Johnson*, or future cases about mandatory arbitration in securities and corporate law—are required to apply Delaware law to resolve it.[127]

Recognizing what might be at stake in *Johnson & Johnson*, institutional investors and members of the bar were quick to respond. In addition to the original defendant's motion to dismiss the complaint,[128] a similar motion was filed by two large institutional shareholders, the California Public Employees' Retirement System (CalPERS) and the Colorado Public Employees' Retirement Association, who joined the case as intervenors,[129] represented by renowned plaintiffs' attorney Deepak Gupta.[130] Curiously, *Johnson & Johnson* presents the rare case where if the motions to dismiss are *granted*, that would be a plaintiff-friendly move.

In their original motions to dismiss, both Johnson & Johnson and the institutional intervenors relied on two lines of argument. The first runs along the internal affairs, corporate law-vs.-securities law axis,[131] primarily based on

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[126] Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

[127] The federal courts are facing this issue under their "federal question" jurisdiction, since both the Securities Acts and the Federal Arbitration Act are federal statutes. Yet, even within its federal question jurisdiction, the *Erie* doctrine requires a federal court to apply state law when faced with a state law question (such as the question "are corporate charters and bylaws 'contracts?'"). *See, e.g.*, Abbe R. Gluck, *Intersystemic Statutory Interpretation: Methodology as "Law" and the* Erie *Doctrine*, 120 YALE L.J. 1898, 1926 (2011) ("[T]he *Erie* doctrine applies in federal-question and federal constitutional cases, just as it does in diversity cases, provided that an analytically separate question of state law is presented.").

[128] Memorandum of Law in Support of Defendant Johnson & Johnson's Motion to Dismiss, Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. May 31, 2019), https://perma.cc/9EDP-A9QZ [hereinafter *Johnson & Johnson* Defendant's Original Motion to Dismiss].

[129] Memorandum in Support of Motion to Dismiss of Proposed Intervenors California Public Employees' Retirement System & Colorado Public Employees' Retirement Ass'n, Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. May 31, 2019), https://perma.cc/JR77-F34X [hereinafter *Johnson & Johnson* Intervenors' Motion to Dismiss].

[130] *See id.* at 30. Among other arbitration-related cases, Gupta represented the appellees before the Supreme Court in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011). *See id.* at 335.

[131] *See Johnson & Johnson* Defendant's Original Motion to Dismiss, *supra* note 128, at 14-28; *Johnson & Johnson* Intervenors' Motion to Dismiss, *supra* note 129, at 9-14.

the Delaware Chancery Court's *Salzberg* decision.[132] The second argument concerns the distinction between corporate law and contract law.[133] At this point, it is worthwhile to pause and discuss *Salzberg*, a case which has received extensive scholarly attention.[134] Existing literature, however, does not primarily focus on the case's possible influence in the more critical *arbitration* context, which this Article now covers.

At issue in *Salzberg* was one primary question: can the charters and bylaws of a Delaware corporation regulate the rights and duties arising *outside* of state corporate law (that is, beyond the realm of "internal affairs"[135])? This question arose after three Delaware corporations, prior to the initial public offering (IPO) of their shares, adopted so-called "federal forum provisions," mandating that plaintiffs must litigate their *federal securities law* claims against the corporation (as opposed to state corporate law claims) only in federal court, despite the 1933 Securities Act's allowance for filing securities claims in state court.[136] While forum selection provisions in regard to state corporate law claims have been allowed since the 2013 *Boilermakers* decision[137] and the 2015 amendment to the Delaware General Corporation Law,[138] *Salzberg* added the

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[132] Sciabacucchi v. Salzberg, No. 2017-0931-JTL, 2018 Del. Ch. LEXIS 578 (Del. Ch. Dec. 19, 2018).

[133] *See infra* note 155 and accompanying text.

[134] *See supra* note 17.

[135] "The internal affairs doctrine . . . holds that the chartering state alone should govern a corporation's 'internal affairs'—what the Restatement (Second) of Conflict of Laws defines as 'the relations inter se of the corporation, its shareholders, directors, officers or agents.' In contrast, the rights and obligations of 'third persons,' namely those other than 'the directors, officers or stockholders of the corporation,' are subject to ordinary conflicts analysis." Vincent S.J. Buccola, *Opportunism and Internal Affairs*, 93 TUL. L. REV. 339, 340 (2018) (footnotes omitted) (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (AM. LAW INST. 1971)).

[136] *See* 15 U.S.C. § 77v(a) (2020) (stating that, in respect to "class actions, [and] all suits in equity and actions at law brought to enforce any liability or duty created by this title," the federal courts' jurisdiction is "concurrent with State and Territorial courts"); Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund, 138 S. Ct. 1061, 1078 (2018) ("[The Securities Litigation Uniform Standards Act of 1998 (SLUSA)] did nothing to strip state courts of their longstanding jurisdiction to adjudicate class actions alleging only 1933 Act violations. Neither did SLUSA authorize removing such suits from state to federal court.").

[137] Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013).

[138] DEL. CODE ANN. tit. 8, § 115 (2020) ("The certificate of incorporation or the bylaws may require . . . that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State . . . .").

internal affairs question into the mix.

In December 2018, the trial court—Delaware's Chancery Court—decided the precedential *Salzberg* case in favor of the plaintiff, who had challenged the federal forum provisions by arguing they violate the "internal affairs" boundary. The court said that "a 1933 Act claim resembles a tort or contract claim brought by a plaintiff who happens also to be a stockholder, but under circumstances where stockholder status is incidental to the claim,"[139] and defined "purchasers of securities" as "parties external to the corporation."[140] Therefore, the federal forum provisions were found to be "ineffective and invalid."[141]

On these grounds, one might also not impose *other* limits on securities litigation (including mandatory arbitration) by placing that limit in a corporation's charter or bylaws. Since the *Johnson & Johnson* original complaint was filed shortly after this decision (and prior to its reversal), the defendant and intervenors broadly relied on it in their original motions to dismiss.[142]

On March 18, 2020, the Delaware Supreme Court reversed.[143] In its *Salzberg* decision, the state's high court devised an entirely new doctrine: the "outer band"[144] theory, according to which certain matters—such as the securities laws—lie outside the "internal affairs" sphere, but still within the scope of the Delaware General Corporation Law.[145] The court reasoned that "[a federal forum provision is] also . . . a provision 'defining, limiting and regulating the powers of the corporation, the directors and the stockholders,' since FFPs prescribe where current and former stockholders can bring [1933 Act] claims against the corporation and its directors and officers."[146] In other words, the fact that the same *people* are involved in both securities and corporate relationships, at least in most cases, was dispositive in the eyes of the court.

[139] Sciabacucchi v. Salzberg, No. 2017-0931-JTL, 2018 Del. Ch. LEXIS 578, at *40 (Del. Ch. Dec. 19, 2018).

[140] *Id.*

[141] *Id.* at *8, *49.

[142] *See supra* note 131.

[143] Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020).

[144] *Id.* at 131.

[145] *See, e.g.*, *id.* ("'[I]ntra-corporate' matters . . . are not necessarily limited to 'internal affairs[]' . . . .").

[146] *Id.* at 115.

The Delaware Supreme Court's *Salzberg* decision thus eliminates *one* ground for opposing Hal Scott's proposal in the *Johnson & Johnson* case: it is now possible to use a corporation's charter or bylaws to control some aspects of federal securities litigation. The former case, however, deals with a far less troubling practice (forum selection, directing plaintiffs to one court, rather than another) compared to the latter (mandatory arbitration, entirely shutting the courthouse doors before any and all plaintiffs).[147] *Salzberg* also does not implicate the FAA, and does not hinge on the question of whether or not corporate charters and bylaws are "contracts,"[148] which is the more fundamental inquiry with regard to arbitration.

Moreover, the *Salzberg* court explicitly rejects the application of *Salzberg* in the mandatory arbitration context, saying that "[s]uch provisions, at least from our state law perspective, would violate [Delaware General Corporation Law] Section 115."[149] Similarly, Professor Joseph Grundfest argues that the outcome in *Salzberg* serves to *preclude*, not promote, mandatory arbitration.[150] In an amicus brief recently filed in California state court, a group of high-ranking Delaware jurists, among them two former Chief Justices of Delaware, also note the difference between forum selection and mandatory arbitration.[151]

These facts did not prevent Hal Scott from stating, in his amended complaint filed after the Delaware Supreme Court's *Salzberg* decision, that "[the decision] eliminates any possible basis for Johnson & Johnson's argument that [Scott's] shareholder-arbitration proposal violates Delaware law."[152] This claim is incorrect. The *Johnson & Johnson* defendants—just like corporations,

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[147] *See supra* note 18 and accompanying text.

[148] In several parts of its opinion, the *Salzberg* court discusses the issue, in a manner consistent with this Article's thesis: charters and bylaws are unique creatures of corporate law, governed by equity principles, rather than contract law. *See infra* notes 329-31 and accompanying text.

[149] *Salzberg*, 227 A.3d at 137 n.169.

[150] *See* Grundfest, *supra* note 17, at 1384-86.

[151] *See* Amicus Brief of Former Delaware Justices, Chancellors, and Vice Chancellors and Professor Joseph A. Grundfest in Support of Motion to Dismiss for Forum Non Conveniens at 5-6, *In re* Dropbox, Inc. Secs. Litig., No. 19-CIV-05089 (Cal. Super. Ct. July 10, 2020), https://static.reuters.com/resources/media/editorial/20200714/dropbox--amicus.pdf (implying that, "[i]n contrast" to federal forum provisions, mandatory arbitration clauses are "objectionable").

[152] *Johnson & Johnson* Complaint, *supra* note 92, at 12. Relatedly, see *supra* note 96 (citing places where the plaintiff refers to corporate bylaws using the word "agreement," or its inflections, without any substantive discussion or attempt to support that claim).

shareholders, and directors who will oppose mandatory arbitration in future cases—still have their second line of argument (also the focus of this Article): the fact that corporate law is distinct from contract law, and therefore,[153] corporate charters and bylaws are not contracts, and are not subject to the FAA or the U.S. Supreme Court's arbitration precedents.[154]

Indeed, both of the original motions to dismiss in *Johnson & Johnson* correctly address this fundamental issue.[155] *Salzberg* detracts nothing from this argument, and even supports it.[156] Part II below develops this reasoning in depth. Prior to that, however, Section I.C explains how ignoring this distinction (perhaps due to the same excessive focus on *Salzberg*'s internal affairs angle, as advanced by Hal Scott) can dramatically alter the landscape of both securities and corporate law enforcement.

As it turns out, by the time Johnson & Johnson filed its new motion to dismiss[157] (responding to Scott's post-*Salzberg* amended complaint), in which the institutional intervenors joined,[158] a few facts had shifted in the case. Most importantly, Johnson & Johnson had *agreed* to let Scott include his arbitration proposal in the 2021 annual meeting[159]—likely, in large part, because it had recognized there is little chance Scott's proposal would win a shareholder majority.[160] Accordingly, the new motion to dismiss mainly

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[153] *See supra* note 20.

[154] *See supra* note 21.

[155] *See Johnson & Johnson* Defendant's Original Motion to Dismiss, *supra* note 128, at 30; *Johnson & Johnson* Intervenors' Motion to Dismiss, *supra* note 129, at 19-26.

[156] *See infra* notes 329-31 and accompanying text.

[157] Memorandum of Law in Support of Defendant Johnson & Johnson's Motion to Dismiss, Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. Nov. 20, 2020), https://perma.cc/T46N-ZYMV [hereinafter *Johnson & Johnson* Motion to Dismiss]. This is the third motion to dismiss filed by Johnson & Johnson in the case; in addition to the original motion to dismiss, *supra* note 128, there was a second motion to dismiss, filed in response to Scott's first amended complaint (his second complaint out of three overall). There is no substantial difference between the first and second amended complaints, or the second and third motions to dismiss, for purposes of the discussion here.

[158] Notice of Joinder of Intervenor-Defendants California Public Employees' Retirement System & Colorado Public Employees' Retirement Ass'n, Doris Behr 2012 Irrevocable Tr. v. Johnson & Johnson, No. 3:19-cv-8828 (D.N.J. Nov. 20, 2020), https://perma.cc/FXJ4-EEDR.

[159] *See Johnson & Johnson* Motion to Dismiss, *supra* note 157, at 3, 12, 21-22.

[160] Approximately eight months after Johnson & Johnson filed its original motion to dismiss, another arbitration proposal made by Hal Scott, similar to the one in *Johnson & Johnson*, has been rejected by 97.6% of Intuit Inc.'s voting shareholders. *See* Intuit Inc., *Form 8-K*,

revolves around procedural arguments such as mootness and unripeness,[161] stating that the court cannot issue an "advisory opinion."[162] At the time this Article is being written, the motion is pending.

Whether or not the *Johnson & Johnson* case is dismissed (and whether or not that decision goes on appeal), it has provided the template for how mandatory arbitration proponents are likely to try introducing it into this new field of law. The unique circumstances that have impeded Hal Scott's arbitration proposal are not expected to repeat in the next round, when corporate *directors* will be the ones making the proposal (or simply inserting an arbitration clause into their corporation's bylaws, without any proposal to shareholders, or anyone else).[163] The same types of substantive arguments raised by both sides in *Johnson & Johnson* will be litigated again—except this time, shareholders (perhaps also derivatively, on behalf of the corporation) will be the plaintiffs, opposing the mandatory arbitration provision. Their success, or lack thereof, will shape a large swath of American law for a long time to come. Section I.C below describes how this scenario might unfold in detail.

C. *The Next Round: Toward Federal Imposition of Mandatory Arbitration in Corporate Law?*

As Section I.A above explains, litigation in courts (particularly the Delaware courts) remains an important, beneficial mechanism for the enforcement of corporate law in the United States. Section I.B has described how proponents of mandatory arbitration have initiated a campaign—now taking its first steps through the federal courts, in the *Johnson & Johnson*

EDGAR (Jan. 27, 2020), https://www.sec.gov/ix?doc=/Archives/edgar/data/896878/000089687820000020/a8-kshellshmtg01232020.htm. In this case, the corporation's directors recommended to shareholders that the proposal be rejected. *See Notice of 2020 Annual Meeting of Stockholders and Proxy Statement*, INTUIT INC. 78 (Nov. 27, 2019), https://www.sec.gov/Archives/edgar/data/896878/000110465919068149/tv531778-def14acourtesy.pdf. This extremely strong opposition to mandatory arbitration only highlights the danger of such provisions being adopted via the bylaw route, where shareholders will not even have a say on the matter, or in other circumstances where directors have the decisive power, *see infra* notes 175-80 and accompanying text. This is especially true for corporations where—unlike Intuit and Johnson & Johnson—directors are less attuned to the corporation's or shareholders' interests (to put it mildly).

[161] *See Johnson & Johnson* Motion to Dismiss, *supra* note 157, at 17-26.

[162] *Id.* at 4.

[163] *See infra* notes 175-77 and accompanying text.

litigation—aimed at (ultimately) making private enforcement of the securities laws substantially more difficult, if not impossible.

This Section merges these two lanes: it explains how the current legal situation might evolve in the long run—specifically, how mandatory arbitration might inject itself first into federal securities law, and from there, expand to state corporate law. This Section also shows that the strongest barrier against this troubling development lies in recognizing that corporate law is separate from contract law, and therefore, the federal courts cannot apply the FAA to corporate charters and bylaws. This, in turn, leads to Part II below, where the distinction between corporate and contract law is developed in depth.

Start where we left off the *Johnson & Johnson* case, in Section I.B. As discussed there, *Johnson & Johnson* revolves around the following question: can a Delaware corporation lawfully channel securities law claims into mandatory arbitration, by adding to its bylaws an arbitration clause that would be covered by the FAA?[164] This question, in turn, splits into two branches, each being dispositive if answered "no": first, can corporate charters and bylaws regulate the rights and duties arising under an external field of law (in this case, securities law)? Second, are corporate charters and bylaws "contracts" subject to the FAA?

The first branch has been affirmatively answered by the Delaware Supreme Court's *Salzberg* decision.[165] Yet, this does not affect the second, corporate-vs.-contract distinction. If the courts adjudicating that question correctly find that charters and bylaws are not contracts,[166] this should end the case, just as much as if *Salzberg* was differently decided.[167] Since the FAA does not apply to corporate charters and bylaws, attempts to enact mandatory arbitration provisions may be subject to review or revocation, either ex ante, through statute (such as Delaware's Section 115),[168] or ex post, through equitable adjudication in state or federal court.[169]

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[164] *See supra* text accompanying notes 116-27.

[165] *See supra* text accompanying notes 143-46.

[166] *See infra* Part II.

[167] *See, e.g.*, Clopton & Winship, *supra* note 22, at 177 ("Under the FAA, arbitration agreements are presumptively valid, irrevocable, and enforceable. This presumption is triggered, however, only if corporate governing documents count as 'contracts' under the FAA."); *supra* note 21.

[168] *See* sources cited *supra* note 71.

[169] If the arbitration clause deals with the litigation of *securities* claims, then it might not be covered by Delaware's Section 115, which pertains to "internal corporate claims." DEL.

Yet, a certain risk arises in the current circumstances of the *Johnson & Johnson* litigation, and future cases in its vein: given all the "brouhaha"[170] over the first dimension—the internal affairs, corporate-vs.-securities issue decided in *Salzberg*, and covered at length by scholars[171]—the federal courts might be led to treat it as dispositive. As discussed above, Scott argues that the *Salzberg* decision "eliminates any possible basis"[172] for finding his proposal contrary to law. In fact, the corporate-vs.-contract distinction—which Scott ignores or minimizes[173] (and future arbitration proponents are likely to, as well)—is equally dispositive in this case, and more important as a general matter. It must not slip under the federal courts' radar. Part II below explains in detail how the courts should resolve this question.

Assume, however, that—even if the issue is fully addressed by the federal courts, including the Supreme Court—corporate charters and bylaws are found to be "contracts" under the FAA, so that the FAA, and the Supreme Court's expansive arbitration jurisprudence,[174] apply to them. What would come next? The first and most obvious effect would be the adoption of arbitration provisions in regard to *securities law* claims. Corporations' directors, in their sole discretion, could simply amend the corporation's bylaws to include an arbitration clause,[175] perhaps with a similar language as Scott's proposal to

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CODE ANN. tit. 8, § 115 (2020). Even so, the arbitration clause would also not be covered by the FAA (and the Supreme Court's arbitration precedents), because it is not part of a "contract." *See supra* note 21. Arbitration can exist outside the scope of the FAA, governed only by state law and non-FAA federal law. As a result, securities plaintiffs will have a space to challenge arbitration clauses ex post, relying on equitable grounds, or the securities laws' anti-waiver provision, *see* 15 U.S.C. §§ 77n, 78cc (2020), or ex ante, through SEC rulemaking. If the arbitration clause deals with the litigation of *internal affairs* claims, it is subject to both Section 115 and the full plethora of state law equitable powers, *see infra* Section II.B.

[170] *Cf.* Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325 (2013).

[171] *See supra* note 17.

[172] *Johnson & Johnson* Complaint, *supra* note 92, at 12.

[173] *See supra* note 152 and accompanying text.

[174] *See supra* Section I.A.

[175] *See, e.g.*, DEL. CODE ANN. tit. 8, § 109(a) (2020) ("[A]ny corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . ."). The vast majority of U.S. public corporations indeed have such a director-empowering clause in their certificate of incorporation. *See, e.g.*, Fisch, *supra* note 40, at 379-80.

Johnson & Johnson.[176] Again, so much for the "contract" metaphor.[177]

Alternatively, directors could use their exclusive power to propose charter amendments,[178] and submit such an arbitration provision to shareholders' vote in the next annual meeting. In fact, this is the only route where shareholders would be *asked*, in any form, whether they wish to "arbitrate"[179] their claims. Even for those corporations that proceed through the charter (rather than bylaws) avenue, acceptance rates for directors' arbitration proposal might be considerable, resulting from shareholders' entrenched collective action problems and directors' vast informational and procedural advantage.[180] Still, *to the extent* shareholders (specifically, large institutional shareholders such as Vanguard and BlackRock) have the opportunity to prevent the adoption of an arbitration clause in a certain corporation,[181] they ought to do so (and are, in fact, obliged to, as fiduciaries for their investors, and in some cases, for the corporations in which they invest).[182]

So far, this Section has discussed the course of mandatory arbitration in the *securities* law realm. Indeed, that is the issue directly being addressed in the *Johnson & Johnson* case.[183] If mandatory arbitration sweeps across the U.S. securities law landscape, we might see a large swath of the securities acts

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[176] *See supra* notes 111-12 and accompanying text.

[177] The unilateral amendment of corporate constitutional documents, by the corporation's fiduciaries, is different than the (seemingly) unilateral modification of an agreement under contract law. *See* Albert H. Choi & Geeyoung Min, *Contractarian Theory and Unilateral Bylaw Amendments*, 104 IOWA L. REV. 1 (2018). The best solution Professors Choi and Min find, for the various problems that arise in the corporate context, is the granting of "equitable relief" through "stronger judicial oversight," which is characterized by "speed and low cost," *id.* at 41. This is precisely the solution that mandatory arbitration makes impossible.

[178] *See, e.g.*, tit. 8, § 242(b)(1).

[179] The quote marks are necessary. *See supra* note 65.

[180] *See, e.g.*, Geeyoung Min, *Shareholder Voice in Corporate Charter Amendments*, 43 J. CORP. L. 289, 296-99 (2018) (discussing the "Failure of [the] Shareholder Right to Veto Charter Amendments" and noting that "[g]iven these structural impediments, it is uncertain whether a shareholder approval requirement in the charter amendment process could effectively prevent directors' opportunistic amendment attempts").

[181] *See, e.g.*, *supra* note 160.

[182] On activist shareholders as fiduciaries for the target corporation, see, for example, Raz, *supra* note 34, at 567-70.

[183] *See supra* Section I.B.

become practically unenforceable, specifically through class actions—a mechanism which the Supreme Court has called "essential."[184] Yet, the U.S. securities arena would not experience a complete return to the Hobbesian state of nature, since there is *some* alternative—albeit far less efficient[185]—enforcement mechanism: civil and criminal actions, brought against securities law violators by the SEC and the Department of Justice.[186] Even this final outlet, however, would not be available when mandatory arbitration spreads to its next target: internal affairs, state corporate law claims.[187]

At this point, we should return to Delaware's Section 115.[188] One might correctly observe that mandatory arbitration of corporate law matters is legally impossible, given the Delaware legislature's express prohibition of that practice.[189] Indeed, this appears to be the argument made by the Delaware Supreme Court in the final part of the *Salzberg* decision.[190] The Delaware court, however, neglected to mention one obvious risk: that a federal court, to whose precedents Delaware is subject, would find corporate charters and

[184] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007).

[185] *See, e.g.*, Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 901-04 (2019) (discussing ways in which SEC enforcement falls short of private litigation, in terms of information production and in other respects).

[186] *See, e.g.*, *Tellabs v. Makor*, 551 U.S. at 313 (discussing the "criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the [SEC]").

[187] There is no state corporate law equivalent to the SEC, and the enforcement of internal affairs law is dependent on private actors. One seeming exception is actions brought by the state Attorney General, *see, e.g.*, DEL. CODE ANN. tit. 8, §§ 124(3), 284, 323, 384 (2020), but these only relate to few, delineated subject matters, and play a small role in the landscape of corporate law enforcement. It is *possible* to try expanding the enforcement of private law by state actors, and some scholars have suggested doing so in the face of the spread of mandatory arbitration. *See, e.g.*, Sarath Sanga, *A New Strategy for Regulating Arbitration*, 113 NW. U. L. REV. 1121 (2019). While state enforcement of private law is better than no enforcement at all, it is still inferior to enforcement by private actors, for the reasons discussed, for example, by Shapira, *supra* note 185. Since Delaware, like all other states, has practically no mechanisms in place for the public enforcement of corporate law, the costs of creating this institutional framework are also likely to be exceptional.

[188] Tit. 8, § 115.

[189] *See* sources cited *supra* note 71.

[190] *See* Salzberg v. Sciabacucchi, 227 A.3d 102, 137 n.169 (Del. 2020) ("Much of the opposition to FFPs seems to be based upon a concern that if upheld, the 'next move' might be forum provisions that require arbitration of internal corporate claims. Such provisions, at least from our state law perspective, would violate Section 115 . . . ."). In addition, even if Section 115 did not exist, mandatory arbitration would still be contrary to corporate law principles, *see infra* Sections II.B, II.C, and should be equitably regulated ex post.

bylaws to be "contracts" under the FAA. In such a case, that court would be set on a road culminating in a declaration that Section 115 is preempted by the FAA, and is therefore invalid for arbitration-related purposes.

How would that road unfold? Again, remember that we are (hypothetically) past the point in which a *Johnson & Johnson*-like case has led the U.S. Supreme Court to find that corporate charters and bylaws are "contracts" subject to the FAA. Assume the directors of some Delaware corporation—possibly one whose fiduciaries are especially eager, for whatever reason, to shield themselves from the reach of law[191]—now insert an arbitration clause into their corporation's bylaws. Instead of dealing only with the "federal securities laws," as in Hal Scott's *Johnson & Johnson* proposal,[192] the internal affairs arbitration clause might mirror the language of Section 115, covering "any or all internal corporate claims,"[193] or claims "based upon a violation of a duty by a current or former director or officer or stockholder in such capacity."[194]

The linguistic possibilities are endless, as are the various ways to defeat any chance for the meaningful enforcement of corporate law: for example, through a "waiver" of the right to file any *derivative* action (rather than only

[191] *See infra* note 204 and accompanying text.

[192] *See supra* note 111 and accompanying text.

[193] Tit. 8, § 115.

[194] *Id.*

class actions),[195] or through "the firm always wins" clause[196]—which, in the corporate context, would translate to "the firm always *loses*," as the corporate entity would be deprived of its ability to hold its fiduciaries accountable for any violation.

Next, one or more shareholders of the Delaware corporation at issue would likely file an action in the Delaware Chancery Court, seeking a declaratory judgment that the arbitration provision is ineffective and invalid, given the clear language of Section 115.[197] The Chancery Court would have a much easier job compared to *Salzberg*,[198] since the arbitration clause squarely comes within the scope of the corporation's internal affairs. After the unlawful provision has been struck down, the director-defendants would likely appeal to the Delaware Supreme Court. If that court takes its own language in the final part of *Salzberg*[199] seriously, it would affirm the Chancery Court's ruling.

The stage would then be set for what might become "Delaware's fall"[200]—and that of American corporations' and shareholders' rights more

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[195] This would eliminate any practical way for the corporate entity to sue its directors and officers for any breach whatsoever, since they will not sue themselves (on behalf of the corporation). Therefore, a waiver of the right to file a derivative action (or derivative arbitration) is precisely equivalent to waiving the right to sue (or arbitrate), full stop. Derivative and class actions are fundamentally different, as the former is filed on behalf of a single person (the corporation), while the latter is filed on behalf of a non-precisely-delineated group of people. *See, e.g.*, Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1265 (Del. 2012) ("[T]he corporation was harmed and the total recovery is awarded to the corporation . . .—not 'nominally' but actually. . . . Delaware law does not analyze the 'benefit achieved' for the corporation in a derivative action . . . as if it were a class action recovery . . . ."). However, in the U.S., a serious error has occurred with respect to Rule 23.1 of the Federal Rules of Civil Procedure: the rule requires that derivative plaintiffs "fairly and adequately represent the interests *of shareholders or members* who are similarly situated in enforcing the right of the corporation or association," FED. R. CIV. P. 23.1(a) (emphasis added). In fact, shareholders are simply not party to a derivative action, which is between the corporate entity (through a representative) and the fiduciary-defendant. The improper phrasing of Rule 23.1 might encourage courts to erroneously view derivative actions as akin to class actions, and to similarly uphold "derivative action waivers" in arbitration clauses.

[196] *See supra* note 63.

[197] *See* sources cited *supra* note 71.

[198] *See supra* text accompanying notes 139-41.

[199] *See* Salzberg v. Sciabacucchi, 227 A.3d 102, 137 n.169 (Del. 2020).

[200] Lynn M. LoPucki, *Delaware's Fall: The Arbitration Bylaws Scenario*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 35 (Stephen M. Bainbridge, Iman Anabtawi, Sung Hui Kim & James Park eds., 2018). For more on this point, see Skeel, *supra* note 79, at 19-20 ("Delaware needs cases; corporate law litigation is the fuel that powers the mighty Delaware corporate law engine. . . . What sets

generally. The director-defendants could seek certiorari from the U.S. Supreme Court. If that writ is granted, and as the Court had already found (within the hypothetical scenario here) corporate charters and bylaws to be "contracts" under the FAA, it might proceed to declare that Delaware's Section 115 is preempted by the FAA, in similar fashion to the *Concepcion* decision[201] and others in its vein. The U.S. Supreme Court would overturn the Delaware Supreme Court's ruling, reinstating the internal affairs arbitration clause in the corporation's bylaws, and opening the floodgates for widespread adoption of such clauses among corporations chartered in Delaware and elsewhere in the U.S.

Clearly, not all American corporations will get mandatory arbitration clauses inserted into their charters or bylaws, in regard to either securities or internal affairs claims. The rise of institutional investor stewardship and proxy advisor oversight,[202] combined with the simple fact that many fiduciaries seek to lawfully meet their duties, while guarding the corporation's and investors' long-term interests—as demonstrated by Johnson & Johnson and Intuit directors' refusal to cooperate with Hal Scott's arbitration proposals[203]—make it plausible that in those corporations where the level of corporate governance is higher to begin with, mandatory arbitration is less likely to materialize.

The problem is more nuanced, however. As can be analogized from Professor Michal Barzuza's research on fiduciary duty waivers,[204] the corporations most likely to get arbitration provisions, in their charters or bylaws, are those that are *more likely to violate the law in the first place* (or see

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Delaware apart is its sophisticated corporate law judiciary and its rich supply of precedents . . . .").

[201] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 352 (2011) ("Because it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' . . . California's *Discover Bank* rule [(prohibiting class action waivers in certain contracts)] is pre-empted by the FAA.") (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). To be certain, Delaware's Section 115 does *not* counter any Congressional objective; in fact, Congress hardly ever says anything about the internal affairs of corporate law, which is the province of the states. In the scenario described here, the federal courts might miss this point.

[202] *See, e.g.*, Fisch, *supra* note 77, at 780.

[203] *See supra* note 160.

[204] Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131 (2018); Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593 (2014); Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935 (2012).

their fiduciaries commit such violations). Whether or not mandatory arbitration clauses become *quantitatively* as prevalent as, say, 102(b)(7) provisions,[205] as a *qualitative* matter, the effect of mandatory arbitration will be significant. Those fiduciaries and entities who *most* require "law," as opposed to "norms" (to invoke Professors Rock and Wachter's terminology)[206] to be disciplined, are the ones who will be able, and incentivized, to place themselves beyond enforceable law. Lawsuits will become impossible precisely where lawsuits are needed.

Moreover, the concept of litigation plays a primordial role in corporate law; without courts of equity, fiduciaries can easily undermine the *non*-judicial mechanisms meant to supervise them, such as shareholder voting, upon which most of activism and stewardship are built.[207] Mandatory arbitration in corporate law is thus likely to generate an unpredictable, systemically complex, and unprecedentedly troubling set of effects.

This Article mainly aims to explain where the hands have come to on the clock, and to demonstrate why corporate law and mandatory arbitration are structurally incompatible; it does not seek to describe all the practical consequences of mandatory arbitration in corporate law—many of which have been analyzed in excellent detail by Professor Ann Lipton.[208] The remainder of this Section, however, discusses a few of those implications, both to stress the magnitude of the issue, and to keep the literature on this point updated in light of recent scholarship.

Just as in consumer and employment law, the root problem with mandatory arbitration in corporate law is that it does *not* channel cases to alternative dispute resolution, but the opposite: it practically eliminates them, leading to impairment of justice, accompanied by a unilateral shift of wealth to the party managing to shut the courthouse doors before the other.[209] Yet,

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[205] *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2020) (allowing for waiver of monetary remedies for duty of care breaches by directors of a Delaware corporation, if a provision to that effect is placed in the corporation's charter). On the prevalence of 102(b)(7) provisions, see Matteo Gatti, *Did Delaware Really Kill Corporate Law? Shareholder Protection in a Post-*Corwin *World*, 16 N.Y.U. J.L. & BUS. 345, 366 (2020) ("[V]irtually all firms incorporated (or reincorporated) in Delaware after July 1, 1986 (when Section 102(b)(7) became effective), and more than 90% of the pre-existing corporations, . . . have managed to pass the charter amendment." (footnote omitted)).

[206] *See* Rock & Wachter, *supra* note 80.

[207] *See, e.g.*, *supra* notes 82, 87 and accompanying text.

[208] *See* Lipton, *supra* note 12, at 626-40.

[209] *See supra* Section I.A.

mandatory arbitration in corporate law also presents its own, distinctive set of issues. Two examples were mentioned shortly above: the derivative action waiver and "the firm always loses" clause.[210] More generally, if arbitration clauses truly are to be enforced "according to their terms,"[211] what would prevent the corporation's fiduciaries—who will almost always be the ones drafting the arbitration provision[212]—from requiring, say, the posting of a $10 million bond as a prerequisite for filing any arbitration claim, or having the directors' own legal counsel sit as arbitrators, or any similar justice-obstructing device?

Furthermore, as Professor Lipton notes, corporate law relies on a set of *representative* enforcement mechanisms, which individualized "arbitration" makes entirely meaningless.[213] By definition, there is no such thing as an "individual" derivative action,[214] nor a "particularized" harm to shareholders, who (by default) all hold units of identical economic magnitude,[215] and respectively share in the effects of corporate and managerial decisions (such as merging the corporation for too low a price,[216] or infringing upon shareholders' voting rights[217]). Arbitration clause drafters might also attempt to waive corporate law's important set of information-revealing tools, without which many lawsuits cannot be initiated or pursued.[218]

Even if every public corporation had just a handful of large

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[210] *See supra* notes 195-96 and accompanying text.

[211] CompuCredit Corp. v. Greenwood, 565 U.S. 95, 98 (2012).

[212] *See supra* notes 175-80 and accompanying text.

[213] *See* Lipton, *supra* note 12, at 632-36.

[214] *See supra* note 195.

[215] *See* Asaf Raz, *Share Law: Toward a New Understanding of Corporate Law*, 40 U. PA. J. INT'L L. 255 (2018).

[216] *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

[217] *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

[218] *See* DEL. CODE ANN. tit. 8, § 220(c) (2020) (providing for a judicial procedure to compel inspection of corporate books and records by shareholders). On the recent rise in the importance of such procedures, see, for example, George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407 (2019); Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3600935.

institutional investors (which is hardly the case),[219] there would still be no economic justification, nor any practical way, to run an identical arbitration five or ten times, for each shareholder anew. As Professor David Webber had found, even in a litigation environment dominated by institutional investors, "loss of the class action would eliminate . . . any remedy for substantial investor losses. . . . [C]ertain types of remedies would cease to be pursued without class action litigation. Specifically even positive-value claimants would no longer pursue remedies such as corporate governance reform."[220] Nor would it be even remotely feasible to submit the exact same breach of law to millions of individual arbitrations, considering retail shareholder ownership.[221] Yet, unless *all* of these proceedings are pursued, the same, single violation can never be fully remedied (or deterred). How does this square with the Supreme Court's praise for "reducing the cost and increasing the speed of dispute resolution?"[222]

These facts hint at an important observation, closely related to this Article's broader thesis. In the corporate context, the Supreme Court *cannot* repeat the claim that "[b]y agreeing to arbitrate . . . , a party does not forgo the substantive rights . . . ; it only submits to their resolution in an arbitral, rather than a judicial, forum."[223] Instead, the party—a shareholder, or the corporation itself—*is* deprived of substantive rights when corporate law's special enforcement mechanisms disappear. Those substantive rights are the product of a distinct legal framework, relying on its own methods of enforcement to address unique, corporate-specific situations.[224] Elimination of corporate litigation means elimination of corporate law as an enforceable legal field, period. Even the most meritorious cases could never be brought,[225] and those

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[219] *See* Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11 (2017) (discussing the important role of individual, non-institutional shareholders in the U.S., and the need for a better policy response to their interests).

[220] Webber, *supra* note 89, at 265.

[221] *See* Fisch, *supra* note 219.

[222] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 345 (2011).

[223] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985).

[224] *See infra* Section II.B.

[225] For detailed discussion of such recent cases, see Friedlander, *supra* note 78. Consider, for example, the highest-recovery shareholder litigation case in Delaware history, *Americas Mining Corporation v. Theriault*, 51 A.3d 1213 (Del. 2012). In that case, the corporation's fiduciaries were penalized in the amount of $2.031 billion for engaging in a self-interested transaction. *See id.* at 1218. Under a mandatory arbitration regime, the fiduciaries could have simply amended the corporation's bylaws prior to the transaction, adding an arbitration clause with various justice-impairing devices. The case could then have not been brought,

who choose to violate the norms of corporate law would get "free lunch," every day, and in respect to any decision, however harmful or irrational.

Accordingly, the insertion of a mandatory arbitration clause, including standard justice-impairing provisions, into a corporation's charter or bylaws, is precisely equivalent to a waiver of equitable and fiduciary duties, which Delaware law has long prohibited, even outside of the arbitration context.[226] Importantly, the FAA and the Supreme Court *do* allow courts to override arbitration clauses, as long as this is done "upon such grounds as exist at law or in equity for the revocation of *any* contract,"[227] or if "arbitration agreements [are placed] on equal footing with all other contracts."[228] Delaware's Section 115, prohibiting mandatory arbitration of corporate law disputes,[229] does indeed place arbitration on equal footing with other "contracts" (or, more correctly, corporate and directorial actions): in every case, a waiver of equitable and fiduciary obligations is legally impossible. This fact, too, must guide the federal courts adjudicating the issue.

Finally, it is unlikely that, over the long term, corporations and shareholders will submit to a regime where their rights are unenforceable. Large institutional investors—from the U.S., and just as importantly, from overseas—can simply shift more money into securities issued by non-American corporations. Similarly, more new incorporations of international businesses might take place in jurisdictions where the nation's highest court did not decide to make corporate law mostly unenforceable. Although fewer cases of misconduct will become publicly known, when future Enron-style scandals (or more recent ones—pick your favorite) *do* get uncovered, outsiders to the U.S. corporate governance system will have a hard time understanding why no civil recourse exists. Just like incorporation, *litigation* would also shift abroad,

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or, if brought, not be decided correctly. The fiduciaries would have gone away with a multi-billion-dollar free lunch.

[226] *See, e.g.*, Sample v. Morgan, 914 A.2d 647, 664 (Del. Ch. 2007) ("An essential aspect of our form of corporate law is the balance between law . . . and equity (in the form of concepts of fiduciary duty). Stockholders can entrust directors with broad legal authority precisely because they know that that authority *must* be exercised consistently with equitable principles of fiduciary duty." (emphasis added)).

[227] Federal Arbitration Act, 9 U.S.C. § 2 (2020) (emphasis added).

[228] Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006). In another case, the Supreme Court has warned that the FAA is intended "to make arbitration agreements as enforceable as other contracts, but not more so." Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 n.12 (1967).

[229] *See* sources cited *supra* note 71.

whenever possible.[230] These developments would harm both the U.S.'s image and its economy.

Is the scenario described in this Section actually going to unfold? As discussed above, the federal courts' approval of mandatory arbitration clauses in corporate charters and bylaws is contingent upon one preliminary finding: that these documents are "contracts."[231] Part II explains why such a finding cannot be made consistent with law.

II. WHAT DEFINES CORPORATE LAW—AND MAKES IT NON-CONTRACTUAL

A. *Corporate Law's Boundary Question: So Far, Unresolved*

> Hohfeld's project . . . seems to promise . . . [that] [t]axonomic activity will be happening. There will be classification. And jurisprudence by subdivision. Oh, joy.[232]

Part I above has discussed the new doctrinal landscape, arising from a pair of recent cases (*Johnson & Johnson* and *Salzberg*), which might lead the federal courts, in the near future, to introduce the practice of mandatory arbitration into the corporate law sphere. This troubling economic and social development hinges on a question of *legal* classification: under state law,[233] is corporate law part of contract law—and by extension,[234] are corporate charters and bylaws "contracts?" Only if they are,[235] can the Federal Arbitration Act, and the Supreme Court's expansive arbitration precedents,[236] enter the corporate law playing field.

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[230] For discussion of corporate and securities litigation outside of the U.S., see, for example, sources cited *supra* notes 114-15.

[231] *See supra* note 21.

[232] Pierre Schlag, *How to Do Things with Hohfeld*, 78 LAW & CONTEMP. PROBS. 185, 186 (2015) (formatting altered) (discussing Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913)).

[233] *See supra* notes 126-27 and accompanying text.

[234] *See supra* note 20.

[235] *See supra* note 21.

[236] *See supra* Section I.A.

This Part turns to a more theoretical approach, connecting with broader scholarship in corporate theory, contract theory, and law and economics, to prove that the answer to that question is squarely "no."

To start with, why do we even have to ask this question now? After all, no one thinks to conflate most *other* areas of private law with contract. No judge, practitioner, or scholar would seriously believe that an act of tort is an act of contract-making. Nor do we consider property law to be a branch of contract law. As this Section illustrates, today's cutting-edge scholarship devotes itself to discerning the unifying principles and legal structures that delineate each of these fields, and many others.

Corporate law, however, has remained different. Despite the huge amount of high-quality corporate scholarship, these taxonomic questions have yet to be clearly answered. At its root, this state of affairs might be grounded in the American tradition of legal realism,[237] which distances itself from legal concepts, classifications, and doctrines. As Professor Felix Cohen famously wrote in 1935, "[a legal] proposition . . . would be scientifically useful if [the legal concepts it uses] were defined in non-legal terms."[238]

Over the last several decades (and in corporate law more than any other area), legal realism has largely morphed into the law and economics movement.[239] Similar to Professor Cohen, many law-and-economists more readily discuss non-legal concepts—say, "externalities" or "Tobin's *q*"[240]—than they do "corporate charters," "equity" or "corporate purpose." When reviewing the work of non-realist scholars, some authors seem to regard the possibility of "corporate law *as law*"[241] with an air of surprise.

As a result, we see a comparatively little amount of scholarship devoted to theoretical, structural questions—what defines corporate law, and why do we have it in the first place?—and a much broader literature dedicated to

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[237] For a discussion of legal realism's influence on U.S. corporate law, see Rock, *supra* note 1.

[238] Cohen, *supra* note 2, at 820.

[239] On the link between these two movements, see Hanoch Dagan & Benjamin C. Zipursky, *Introduction: The Distinction Between Private Law and Public Law*, *in* RESEARCH HANDBOOK ON PRIVATE LAW THEORY 1, 7-9 (Hanoch Dagan & Benjamin C. Zipursky eds., 2020); Smith, *supra* note 4, at 46-48.

[240] *See, e.g.*, Bartlett & Partnoy, *supra* note 28.

[241] Bratton, *supra* note 26 (emphasis added).

important, yet more dynamic issues, such as dual-class shares,[242] staggered boards,[243] executive compensation,[244] and so on.[245] Corporate-specific legal concepts, such as corporate personhood, which in fact play a significant role in the daily operation and economics of business organizations,[246] are often left by the scholarly wayside.[247]

Among other effects, this has resulted in the rise of the "contract" and "private ordering" metaphors in corporate legal academia.[248] After all, if we do not have to deal with definitions and categories, why not assume that corporate law has very little structure of its own, and is just part of something else, more intuitive to understand (that is, contract law)? When corporate law scholars depart from the "contract" metaphor, they tend to replace it with another, such as "property"[249] or "agency."[250] Quite simply, "[w]hat *all* of these scholars have

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[242] *Compare, e.g.*, Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585 (2017) (advocating the adoption of "sunsets," terms in corporate constitutional documents that mandate the cancellation of the more senior class of shares a certain period of time after its issuance), *with, e.g.*, Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057 (2019) (criticizing such terms).

[243] *See, e.g.*, Yakov Amihud, Markus Schmid & Steven Davidoff Solomon, *Settling the Staggered Board Debate*, 166 U. PA. L. REV. 1475 (2018).

[244] *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

[245] Regarding the distinction between structural and dynamic legal concepts, see Balganesh & Parchomovsky, *supra* note 27; Raz, *supra* note 34, at 525-26, 531-32.

[246] On the economic and practical importance of corporate personhood (which is often not called that, but instead referred to using terms such as "entity" or "firm"), see, for example, Raz, *supra* note 34, at 539-48.

[247] *See, e.g.*, Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657, 661 ("Companies do not act; individuals within them do."). If we choose, from the outset, to treat one of corporate law's building blocks—personhood—as transparent, all corporate affairs would pass off merely as direct relationships between stakeholders, fiduciaries, and shareholders. In practice, however, most of the frameworks discussed in Professor Lipton's article as constraining "directors"—for example, employment and environmental law—actually bind the corporation itself. As a rule, neither directors, nor shareholders, can be sued for breach of these non-corporate legal norms. For further discussion of the significance of the corporation's entity status, see *infra* Section II.B.

[248] *See, e.g.*, sources cited *supra* note 3.

[249] *See, e.g.*, sources cited *supra* note 32.

[250] *See, e.g.*, Heaton, *supra* note 31, at 207-14 (surveying in detail the development of "agency costs" as a central concept in corporate academic literature).

failed to consider is one possibility: corporate law is corporate law."[251] Even when, finally, discussing corporate law as such, authors often overlook at least one of its defining properties, leading to highly fragmented discourse.[252]

At the bottom line, corporate law suffers from a multi-faceted "low-visibility problem."[253] With the specter of mandatory arbitration (leaning on the confusion between corporate and contract law), this problem now threatens the very existence of corporate law as an enforceable framework.[254]

This predicament is not shared by other areas of private law, which have largely re-embraced *legal* inquiry. In 2000, renowned legal philosopher Jeremy Waldron wrote that "any steps we have taken down th[e] road [offered in Cohen's 1935 article[255]] have been taken without giving up the conceptual terminology of traditional legal analysis."[256] As Professor Ronald Coase, one of the greatest law and economics scholars in history, said in his 1991 Nobel Prize lecture, "the legal system [has] a profound effect on the working of the

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[251] Raz, *supra* note 34, at 581. To be certain, several works do discuss corporate law's boundary question—what distinguishes corporate law from other legal frameworks, and why do we need it at all?—in various contexts. *See, e.g.*, William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1819 (2013) ("The theoretical interest concerns the problem of defining the corporation's boundaries, asking the 'who's in and who's out' question regarding the line dividing fiduciary beneficiaries from contract counterparties."); Ofer Eldar & Andrew Verstein, *The Enduring Distinction Between Business Entities and Security Interests*, 92 S. CAL. L. REV. 213 (2019) (comparing corporate law and the law of security interests in property); John Morley, *The Common Law Corporation: The Power of the Trust in Anglo-American Business History*, 116 COLUM. L. REV. 2145 (2016) (arguing that trust law is capable of producing many of corporate law's benefits); Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 652 (2002) (arguing that, from a Coasean viewpoint, corporate law and trust law are fundamentally different, since the former lies in the "firm context" and the latter in the "market context"); Andrew Verstein, *Enterprise Without Entities*, 116 MICH. L. REV. 247 (2017) (arguing that contract law, particularly as applied in reciprocal insurance exchanges, is capable of producing many of corporate law's benefits). Yet, some of these works *reject* the view that corporate law is substantively distinct from other areas; and none of them are aimed at systematically addressing corporate law's underlying principles.

[252] *See, e.g.*, Raz, *supra* note 34, at 525-26, 533.

[253] *See supra* notes 26-36 and accompanying text.

[254] *See supra* Part I.

[255] Cohen, *supra* note 2.

[256] Jeremy Waldron, *"Transcendental Nonsense" and System in the Law*, 100 COLUM. L. REV. 16, 17 (2000).

economic system and may in certain respects be said to control it."[257]

Recently, Professor Hanoch Dagan and co-authors have argued that "markets arise out of and operate through law—not just through public regulation but also through private law regimes . . . that create entitlements, enforce market exchanges, and limit expropriation."[258] Even in the context of blockchain—which has been initially perceived as an almost polar alternative to legal ordering, where "anything goes" if only you can code it—legal norms and concepts, including contract principles and litigation in courts, strongly persist.[259] Put simply, law came before the market, and it is a predicate for private ordering, not the other way around.[260]

Accordingly, structural theory enjoys a respectable role in the fields of property, tort, and of course, contract. In each of these areas, scholars make a nuanced effort to locate the underlying, unifying principles of the particular legal framework: for example, Professor Randy Barnett concludes that the foundation of contract law is "consent";[261] Professors Thomas Merrill and Henry Smith discuss the reduction of information costs through the *numerus clausus* principle in property law;[262] and Professors John Goldberg and Benjamin Zipursky have recently formulated a new theoretical justification for tort law.[263] These works, which today are increasingly associated with the New

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[257] Ronald H. Coase, *Lecture to the Memory of Alfred Nobel*, NOBEL PRIZE (Dec. 9, 1991), https://www.nobelprize.org/prizes/economic-sciences/1991/coase/lecture.

[258] Hanoch Dagan, Avihay Dorfman, Roy Kreitner & Daniel Markovits, *The Law of the Market*, 83 LAW & CONTEMP. PROBS. i, i (2020).

[259] *See* Shaanan Cohney & David A. Hoffman, *Transactional Scripts in Contract Stacks*, 105 MINN. L. REV. 319 (2020).

[260] This statement has no collectivist overtones, but the opposite of that. To have free markets, it is imperative to have a functioning, credible legal system, where rights are actually enforced (as opposed to, say, the current U.S. system of consumer and employment law, dominated by mandatory arbitration). Legal frameworks such as corporate law distinctively contribute to entrepreneurship and economic productivity, thanks to their *legally*-generated structure. *See infra* Section II.B.

[261] *See, e.g.*, Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986).

[262] Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 YALE L.J. 1 (2000).

[263] JOHN C.P. GOLDBERG & BENJAMIN C. ZIPURSKY, RECOGNIZING WRONGS (2020). Indeed, high-level theory remains especially prevalent in the field of tort law, as it has been for many decades. *See, e.g.*, ERNEST J. WEINRIB, THE IDEA OF PRIVATE LAW (1995) (discussing the fundamental nature of private law, mainly using tort law examples and doctrines).

Private Law movement,[264] sharply contrast with legal realism's neglect of legal concepts and categories. At the same time, they respond to Professor Cohen's criticism[265] in that they are neither formalistic, nor divorced from economic and social realities.[266]

Why should corporate law be any different?[267] After all, even under its expansive arbitration jurisprudence,[268] the Supreme Court would not apply the FAA to an arbitration clause in a deed of property, because it is not a contract,[269] and there was no "consent" by external parties to be bound by it. Similarly, if a heavy object fell on a person from the third floor of a nearby building, the Court would place the case in the correct category—tort law—and would rightly ignore a presumed "arbitration clause" that was, say, affixed to the side of the building, in such a manner that the victim could neither read it prior to being hit, nor agree to it. Similarly, it is time to take corporate law at face value: a distinct legal field, having its own structure and practices, meant to deal with a unique set of real-world situations, and separate from contract law (or any other framework).

The following Section does precisely that. Specifically, it demonstrates that, like other branches of private law, corporate law has a *unifying principle*: the *open-endedness* of the corporation's activities and relationships. This legally-generated principle, and its economic and social implications, have no equivalent in other fields of law; and, as the discussion below indicates, they make corporate law not merely different, but in some respects the *opposite* of

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[264] *See, e.g.*, THE OXFORD HANDBOOK OF THE NEW PRIVATE LAW (Andrew S. Gold, John C.P. Goldberg, Daniel B. Kelly, Emily L. Sherwin & Henry E. Smith eds., 2020); NEW PRIV. L., http://blogs.harvard.edu/nplblog (last visited Apr. 2, 2021).

[265] Cohen, *supra* note 2.

[266] A clear example is Professors Merrill and Smith's justification of a legal concept (the *numerus clausus* principle of property law) in both doctrinal and economic terms (the reduction of information costs). *See* Merrill & Smith, *supra* note 262.

[267] Professor Paul Miller has recently written about corporate law within the framework of New Private Law. *See* Paul B. Miller, *Corporations*, *in* THE OXFORD HANDBOOK OF THE NEW PRIVATE LAW 341 (Andrew S. Gold, John C.P. Goldberg, Daniel B. Kelly, Emily L. Sherwin & Henry E. Smith eds., 2020). This Article continues and deepens these efforts.

[268] *See supra* Section I.A.

[269] In some cases, a document that serves as a deed of property might *also* be a contract, if the requirements for contract formation have been met. By itself, a deed of property is not a contract, and has no "parties" in the contractual sense, as it is binding on all the people in the world (*in rem*). It derives its normative power not from the consent of each of these people, but from property law *as law*. *See supra* note 20.

contract law.

B. *Corporate Law's Defining Property: The Open-Endedness Principle*

In a recent article, Professors Zohar Goshen and Doron Levit point to an intriguing fact:

> Almost every aspect of corporate governance that was studied in the last forty years yielded conflicting empirical findings, for instance: dual-class shares; anti-takeover defenses, such as poison pills, staggered boards, and protective state legislations; hedge-fund activism; and the strength of corporate governance as measured by several indices.[270]

How can this be? As this Section explains—for the first time in corporate law scholarship—the lack of persistent findings is due to no fault of empirical researchers. Rather, it is one effect of corporate law's *legal* structure (as opposed to economic or political structure),[271] which involves the concepts of purpose, personhood, equity, and fiduciary duty.[272] These concepts are found together *only* in corporate law, and they manifest through a number of well-studied phenomena, discussed below, including the business judgment rule,[273] capital lock-in,[274] asset partitioning,[275] and perpetual existence.[276]

This legal structure, in turn, is tied to a unifying principle: open-

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[270] Zohar Goshen & Doron Levit, *Irrelevance of Governance Structure* 2-3 (Eur. Corp. Governance Inst., Working Paper No. 606, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3340912 (citation and footnotes omitted).

[271] *See supra* notes 28-29 and accompanying text.

[272] *See* Raz, *supra* note 34, at 533-66.

[273] *See, e.g.*, Cox, *supra* note 20, at 264 ("Flexibility within the corporation occurs through a centralized board that operates under an unconstrained corporate charter whose decisions are insulated by overwhelming deference provided by the business judgment rule.").

[274] *See, e.g.*, Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003).

[275] *See, e.g.*, Hansmann & Kraakman, *supra* note 32, at 390 ("[O]rganizational law . . . provide[s] for the creation of . . . 'asset partitioning' that could not practicably be established [without organizational law].").

[276] *See, e.g.*, Andrew A. Schwartz, *The Perpetual Corporation*, 80 GEO. WASH. L. REV. 764 (2012).

endedness. Corporate law is meant to facilitate a wide range of eventualities that neither involved parties, nor legislators, nor judges, nor scholars can predict, plan, or regulate before-the-fact (ex ante). Corporate law is an ex post framework. It is about making very little information available to anyone in advance; instead, it lets the corporate entity pursue open-ended adventures, and disciplines it (or its human representatives) after-the-fact, in courts of equity, through inquiry into what is right and just at the present moment. What corporate law *does* mandate ex ante is this regime of ex post supervision. *That* is the "bargain" entities and shareholders "agree" to when they step into the domain of corporate law. As this Section originally explains, this structure also generates a powerful set of economic and social benefits, only achievable through corporate law.

Importantly, this open-endedness principle also makes corporate law very different—in fact, almost the opposite—from another legal framework: contract law. In a way that is more familiar to economic scholars,[277] contract law is built around a principle of ex ante consent.[278] It is about making promises before-the-fact, and enforcing them in the manner they were made. Although "parties to a contract are free to be as whimsical or fanciful as they like in describing the promise to be performed,"[279] from the moment the contract comes into being, it *limits* the parties' autonomy and freedom of action, under pain of legal sanction. As the Restatement (Second) of Contracts says, "[a] contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."[280] Contract law hinges on consent,[281] and that consent, in turn, has to be *to* something.[282]

Contract law permits for *some* ex post wiggle room, partly stemming

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[277] *See* Saul Levmore, *The Ex-Middle Problem for Law-and-Economics*, 22 AM. L. & ECON. REV. 1, 2 (2020) ("Law-and-economics is driven by an ex ante perspective.").

[278] *See, e.g.*, Barnett, *supra* note 261.

[279] Merrill & Smith, *supra* note 262, at 3.

[280] RESTATEMENT (SECOND) OF CONTRACTS § 1 (AM. LAW INST. 1981).

[281] *See, e.g.*, Barnett, *supra* note 261.

[282] *See, e.g.*, Cox, *supra* note 20, at 279 n.91 ("[T]he requirement of definiteness is not a matter that the parties can waive if they are to have a contract. Indeed, it is tautological to argue that the parties can agree to an indefinite level of performance, since there cannot be an agreement if parties do not know to what they have agreed.").

from the fact that contracts are inherently incomplete.[283] Yet, even such intervention is shaped by whatever subject matter the parties have agreed to before-the-fact. The Delaware Chancery Court has expanded on this point:

> The temporal focus is critical. Under a fiduciary duty . . . analysis, a court examines the parties as situated *at the time of the wrong*. . . . [L]iability depends on the parties' relationship when the alleged breach occurred, not on the relationship as it existed in the past. [A contract law] claim, by contrast, looks to the past. . . . [It asks] what the parties would have agreed to . . . *at the time of contracting*.[284]

Corporate law stands firmly on the ex post side. To begin with, every corporation is a legal person.[285] Two well-known concepts—asset partitioning and capital lock-in—can be viewed as different aspects of corporate personhood. Because the corporate person owns its own assets (and owes its own obligations), entirely separate from its shareholders (who, in turn, have *their* own assets and obligations), corporate law generates a distinct economic pool that cannot be touched by shareholders' creditors.[286] Nor, just as importantly, can it be touched by shareholders themselves: capital lock-in mandates that "individual shareholders [cannot] remov[e] productive business assets at will."[287] These achievements can only be unlocked by corporate law,

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[283] *See, e.g.*, Scott Baker & Kimberly D. Krawiec, *Incomplete Contracts in a Complete Contract World*, 33 FLA. ST. U. L. REV. 725, 725 (2006) ("Contracts are never fully complete, because some contractual incompleteness is inevitable, given the costs of thinking about, bargaining over, and drafting for future contingencies.").

[284] ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC, 50 A.3d 434, 440 (Del. Ch. 2012) (emphases added) (formatting altered). For detailed analysis of this temporal distinction, see Daniel Markovits, *Sharing* Ex Ante *and Sharing* Ex Post*: The Non-Contractual Basis of Fiduciary Relations*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 209 (Andrew S Gold & Paul B Miller eds., 2014). Specifically, with regard to the open-endedness principle discussed here, see *id.* at 214 ("Contract partners do not engage each other concretely, through their peculiar interests and for the particular persons that they are *or develop into*." (emphasis added)).

[285] On corporate personhood as a defining building block of corporate law, and its many practical implications, see, for example, KRAAKMAN ET AL., *supra* note 19, at 5-8 (discussing "[l]egal personality" as a "core structural characteristic[]" of the corporation); John C. Coates IV, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 818-35 (1989) (discussing the corporation's entity nature in detail); Raz, *supra* note 34, at 539-48.

[286] *See, e.g.*, Hansmann & Kraakman, *supra* note 32.

[287] Elisabeth de Fontenay, *Individual Autonomy in Corporate Law*, 8 HARV. BUS. L. REV. 183, 201 (2018).

as law;[288] no other private law framework enables us to create a new, non-human legal person, with its own set of rights and duties.

Next, the corporation is endowed with extremely broad capacity to operate in the world. Some corporate statutes declare that "a business corporation shall have the legal capacity of natural persons to act,"[289] while others provide it with a very extensive list of "[s]pecific powers,"[290] practically equaling those of a human being. The corporation can use these human-like powers "to engage in any lawful act or activity."[291] Both the "any" and the "lawful" are highly consequential. Like any other person, the corporation is required to obey the law.[292] For example, when a corporation makes a contract, it has to be fulfilled—but that is because the corporation is a person, subject to general law, *not* because of any ex ante command within corporate law itself.

To the contrary, corporate law nowhere tells corporations *which* acts or activities to engage in. Just as a human's life is open-ended, in the sense that no law tells the person which contracts or voluntary relationships to participate

[288] *See, e.g.*, KRAAKMAN ET AL., *supra* note 19, at 31; Hansmann & Kraakman, *supra* note 32, at 390.

[289] 15 PA. CONS. STAT. § 1501 (2020). The Model Business Corporation Act similarly provides that "every corporation . . . has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs." MODEL BUS. CORP. ACT § 3.02 (AM. BAR ASS'N 2016).

[290] DEL. CODE ANN. tit. 8, § 122 (2020).

[291] *Id.* § 102(a) ("The certificate of incorporation shall set forth: . . . The nature of the business or purposes to be conducted or promoted. It shall be sufficient to state . . . that the purpose of the corporation is to engage in any lawful act or activity . . . ."). Note that the "any lawful act" language has its origins in the idea of general incorporation, which replaced the early nineteenth century model of incorporation by special legislation and for pre-specified goals. *See, e.g.*, Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1634-40 (1988). Some corporations might replace the "any lawful act" language with a narrower goal, or otherwise modify certain default characteristics of corporate law (for example, by specifying pre-determined dividend distributions, or setting a limited lifetime for the corporation, after which it has to liquidate and distribute its residual value). Yet, this is simply a matter of (inherently imprecise) cost-benefit analysis at a particular corporation: it means that the corporation would be more constrained in its actions, and would not be capable of producing the same unpredictable range of eventualities (often extremely positive ones) that is, by default, the hallmark of corporations.

[292] *See, e.g.*, Raz, *supra* note 34, at 549 n.135.

in, so is a corporation's. Many adventures,[293] or misadventures,[294] can transpire. When we add the corporation's perpetual existence into the mix,[295] the range of potential endeavors grows even further, well beyond that of a human. The open-endedness principle is perhaps most famously facilitated by the business judgment rule (again, a concept limited to corporate law),[296] mandating that "in the absence of facts showing self-dealing or improper motive, a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized in good faith"[297]—no matter what the decision actually *is*. Contract law, with its ex ante nature, cannot (and is not meant to) achieve anything similar.

Consider, for example, a corporation like Google. Would it be possible for anyone to write an ex ante contract that dictates—even in broad strokes—the details of all the corporation's future activities? Such a task is impossible, at any point in time (both at the corporation's founding, and any "midstream" moment of its existence). The reason is that people can predict or

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[293] *See, e.g.*, Jatan Mehta, *How SpaceX's Falcon Heavy Could Enable Fantastic Science in the Outer Solar System*, MEDIUM (Mar. 28, 2018), https://medium.com/teamindus/a051d65a2b0a.

[294] *See, e.g.*, DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM (2005) (discussing many corporate misdeeds, including the Enron scandal, as related to corporations' partly legitimate risk-taking behavior).

[295] *See* tit. 8, § 102(b)(5) (stating that, unless the certificate of incorporation specifies otherwise, "the corporation shall have perpetual existence"); Schwartz, *supra* note 276.

[296] *See, e.g.*, *In re* Viacom Inc. Stockholders Litig., Consol. C.A. No. 2019-0948-JRS, 2020 Del. Ch. LEXIS 373, at *3 (Del. Ch. Dec. 29, 2020) (noting, while discussing the business judgment rule, that "the conduct of corporate fiduciaries is given less judicial scrutiny than the conduct of trust fiduciaries"); Rock & Wachter, *supra* note 251 (discussing the lack of a business judgment rule in trust law); Robert H. Sitkoff, *Fiduciary Principles in Trust Law*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 41, 41 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) ("[T]he trust law duty of care . . . is not softened by a business judgment rule."). Contract law, as well, does not have any concept that is analogous to the business judgment rule.

[297] Gagliardi v. Trifoods Int'l, 683 A.2d 1049, 1051 (Del. Ch. 1996). For more on this point (and its relation to the open-endedness principle), see Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's* Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1275 (2001) ("The Delaware Model . . . provides corporate managers with the flexibility to do practically any lawful act, subject to judicial review focused on whether the managers were properly motivated and not irrational.").

plan the future only to a limited extent.[298] Naturally, and at however high investment of money and effort, no one could (or can today) even *imagine* most of the activities Google would engage in within a long-enough period of time.[299] What began as purely a search engine developer turned into a corporation dealing with such projects as YouTube and autonomous cars. If Google's existence was based on "contract," as opposed to corporate law, none of these feats could be achieved, or they would require an *infinite* cost at the contract drafting stage; they would require omniscience. Corporate entities both change the world, and adapt to it, in numerous, entirely unforeseeable ways. Through this, corporate law encourages innovation and entrepreneurship, in a manner that is impossible to attain by any other legal device.

As a result, both contractarians (arguing that corporate law merely provides "default rules" in a contract between shareholders and managers),[300] and property theorists (arguing that corporate law simply draws lines between distinct pools of property, in turn reducing contracting costs with stakeholders),[301] are missing the bigger picture. Corporate law does something more profound: through its open-endedness principle, it creates a whole new actor, free from the shackles of pre-existing obligations, and sends it off to pursue unlimited adventures. The infinite cost of planning all future activities through contract is reduced to less than one hundred dollars—the filing fee for establishing a new corporation.[302] That is, to say the least, anything but trivial.[303]

The discussion so far has focused on the *benefits* generated by

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[298] *See, e.g.*, Baker & Krawiec, *supra* note 283, at 725.

[299] *See* Raz, *supra* note 34, at 547-48.

[300] *See, e.g.*, sources cited *supra* note 3.

[301] *See* Hansmann & Kraakman, *supra* note 32, at 401-03.

[302] *See, e.g.*, *Division of Corporations Fee Schedule*, DEL. DEP'T OF ST. 1 (Aug. 1, 2020), https://corpfiles.delaware.gov/Augustfee2020.pdf (indicating that the filing fee for establishing a new Delaware corporation is $89). Of course, corporate law is not the single driver of economic activity and wealth formation in any society, but it is an important one. *See, e.g.*, William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1287 (2001) ("[E]lementary variables such as technology, education, availability of capital, and even social values such as diligence and self-restraint, are vital ingredients as well. But . . . it [is] clear . . . that the law of enterprise organization plays an important role in facilitating economic welfare.").

[303] *Cf.* Black, *supra* note 3.

corporate law's open-endedness principle—namely, efficiency and innovation, facilitated by corporate personhood, the "any lawful act or activity" statutory language, perpetual existence, and the business judgment rule. Although the trajectory of the corporation's life is open-ended, the same is not true of corporate *law* itself. Corporate law does not only confer power; it also imposes duties. Unlike in a contract, however, those duties are not delineated before-the-fact. Instead, they are based on concepts of purpose, equity and fiduciary duty, calling for a judicial inquiry that examines "the parties' relationship as it existed at the time of the wrong"[304]—meaning ex post.

As a general matter, if it does *not* violate the norms of corporate law, the corporation can *fail*—going bankrupt, or dissolving with zero net worth—with its residual claimants receiving no compensation at all. This fact is implicit in the very concept of a residual claim, which again, is unique to corporate law.[305] This is the opposite of contract law, where *by definition*, a failure to perform the subject matter generates a right for remedy.[306] The corporation is neither a contractual counterparty to shareholders, nor their fiduciary.[307] This does not mean, however, that shareholders have no claims at all. It just means that those rights are shaped within corporate law itself, and subject to its open-endedness principle, using tools of equity and ex post review.

For example, even if we could somehow tell the corporation's fortunes in advance (which we cannot)—say, that the corporation's net worth on December 31 next year will be precisely $1 billion—shareholders would *still* be exposed to a wide variety of unpredictable scenarios. One category of such events is share dilution: at any given moment, the corporation might increase its outstanding share capital, by allocating additional shares to new owners, thus decreasing each current shareholder's relative stake in the corporation's residual value (along with other rights, such as voting). The corporation *can* do this—nothing says otherwise, ex ante—but it must do it in an equitable manner. Delaware law has dealt with intricate sets of circumstances in this context.[308] More generally, the range of situations that might occur in the

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[304] ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC, 50 A.3d 434, 440 (Del. Ch. 2012).

[305] *See* Raz, *supra* note 215, at 272-78.

[306] *See, e.g.*, *supra* note 280 and accompanying text.

[307] *See, e.g.*, *In re* Stillwater Capital Partners Inc. Litig., 851 F. Supp. 2d 556, 573 (S.D.N.Y. 2012) ("A corporation does not owe a fiduciary duty to its shareholders . . . ."); Alessi v. Beracha, 849 A.2d 939, 950 (Del. Ch. 2004) ("Earthgrains [(defendant corporation)] owes no fiduciary duty to Alessi [(plaintiff shareholder)].").

[308] *See, e.g.*, Gentile v. Rossette, 906 A.2d 91 (Del. 2006) (resolving a situation where shareholders' economic and voting rights have both been diluted); Feldman v. Cutaia,

corporation-shareholder relationship extends beyond any example we may be aware of at the present moment; corporate law generates and responds to unexpected, perhaps even odd, events, of which neither the substance, nor the parties being affected, can be known before-the-fact.[309]

The same holds true for the law of corporate purpose: that the corporation can "engage in any lawful act or activity"[310] does not mean that a for-profit corporation, for example, may start acting like a charitable or nonprofit corporation. In a series of cases, including 1989's *Paramount v. Time*[311] and 2010's *eBay*,[312] the Delaware courts have held that the for-profit corporation's purpose is the lawful pursuit of profit.[313] Directors and officers, by unilateral action (either charter or bylaw amendment, or the ongoing management of the enterprise), cannot abuse the fact that the law of corporate purpose is not clearly delineated in statute or contract. Once again, the courts are required to divine the equitable substance of corporate law, ex post.

As this Section has shown, corporate law has none of contract law's building blocks: neither consent, nor ex ante promises, nor sanction for breach. Corporate law has different components: purpose, entity status, and ex post equitable supervision accompanied by fiduciary duties. While contract law has

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956 A.2d 644, 655 (Del. Ch. 2007) ("A claim for wrongful equity dilution is premised on the notion that the corporation, by issuing additional equity for insufficient consideration, made the complaining stockholder's stake less valuable."); Mira Ganor, *The Power to Issue Stock*, 46 WAKE FOREST L. REV. 701 (2011) (discussing the law and theory of share dilution).

[309] *See, e.g.*, Verified Complaint, Shekhawat v. Kumar, No. 2019-0079-AGB (Del. Ch. Feb. 6, 2019) (asking for remedy following an allegedly inequitable reverse share split, at a ratio of 1-for-2,185,000, designed to strip the plaintiff of his shares, specifically in order to forestall another shareholder litigation case filed by the plaintiff); Verified Petition for Equitable Relief at 1, *In re* Heat Biologics, Inc., No. 2019-0741-JTL (Del. Ch. Sept. 13, 2019) (asking for remedy *ex parte*, such "that the Court deem the Company to have received approval from the holders of a majority of the outstanding shares" for a proposal necessary to maintain NASDAQ listing, since the corporation could not *actually* receive such approval, as a large fraction of its public shareholders happen to reside in Germany, where proxy materials cannot be adequately distributed to shareholders and received from them). For an ever-replenishing source of similarly unpredictable corporate law stories, see Columns by Matt Levine, BLOOMBERG, https://www.bloomberg.com/opinion/authors/ARbTQlRLRjE/matthew-s-levine (last visited Apr. 2, 2021).

[310] DEL. CODE ANN. tit. 8, § 102(a)(3) (2020).

[311] Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

[312] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).

[313] *See* Raz, *supra* note 34, at 536-39.

its unifying principle of consent, corporate law rests on a principle of open-endedness. Corporate law confers power upon entities and their fiduciaries to embark on unpredictable adventures, nowhere prescribed ex ante, but it also disciplines the use of that power ex post. When we move away from the more extreme form of legal realism, and examine corporate law *as law*, we also find that it distinctively facilitates innovation, entrepreneurship, and other desirable economic and social values.

If we accept that what the law says matters, the difference between corporate and contract law—specifically under the most important jurisdiction in this area, Delaware—cannot be ignored. Any attempt to treat corporations in an ex ante manner, as if they were contracts, leaves no choice but either to eliminate the economically beneficial freedom of action provided by corporate law, or to abandon its ex post remedial mechanisms, basically handing a gift to wrongdoing corporate actors. When deciding the question of mandatory arbitration in corporate law,[314] the federal courts, relying on state law,[315] have no ground for conflating these two, very distinct legal frameworks.

C. *How We Use the Word "Contract" in Corporate Law: Either Metaphor or Error*

> A contract means something. It's the law, and it's enforceable.
> Deal with it.[316]

Given this Article's bright-line argument—corporate law is not contract law, but an independent legal category, with its own principles, structure, and economic and social implications—one might justifiably wonder: how does this settle with the common use of the *word* "contract" in both corporate law cases and corporate academic literature? Although corporate charters and bylaws are never described as "contracts" in the Delaware statute,[317] the Delaware courts do seem to be calling them that.[318]

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[314] *See supra* Part I.

[315] *See supra* notes 126-27 and accompanying text.

[316] Attorney Kim Wexler, in *Better Call Saul* (AMC Networks Mar. 2, 2020).

[317] Delaware General Corporation Law, DEL. CODE ANN. tit. 8 (2020).

[318] *See, e.g.*, Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) ("Corporate charters and bylaws are contracts . . . ."); Morris v. Am. Pub. Utils. Co., 122 A. 696, 700 (Del. Ch. 1923) ("That a corporate charter is a contract has been long settled.").

Similarly, the term "contract" is a mainstay of corporate law scholarship, especially on the law and economics side.[319]

This Section proves that both of these corpuses of text are using the word in one of two ways: either as a metaphor,[320] intended to broadly allude to some similarities—but certainly not an identity—between charters and contracts; or as a simple error, ignoring what corporate law actually says and does. The use of "contract" in corporate law is thus similar to its use in phrases such as "the social contract."[321] It is also akin to how the term "fiduciary" is employed in constitutional and administrative law: a useful comparison, informing and enriching our understanding of the legal device,[322] but in no way one that can be used to invoke the entire structure, doctrines, and rules of contract (or fiduciary) law, in a manner that can be directly applied to corporations (or the U.S. government).[323]

In Delaware cases, the word "contract" is occasionally invoked in connection with corporate charters and bylaws.[324] Opponents of private law enforcement are likely to try and take advantage of this terminology in the upcoming mandatory arbitration debate.[325] In reality, however, the Delaware courts are using that term in a highly qualified manner—making it so different from *actual* contract, as defined by contract law,[326] that it can only be construed as a metaphor. The word "contract" is subordinated to the inherently *non-contractual* concepts[327] of equity's primacy, broad judicial oversight, and ex post

[319] *See, e.g.*, sources cited *supra* note 3.

[320] *See, e.g.*, Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779 (2002).

[321] JEAN-JACQUES ROUSSEAU, THE SOCIAL CONTRACT (G. D. H. Cole trans., Prometheus Books 1988) (1762).

[322] *See, e.g.*, Andrew Kent, Ethan J. Leib & Jed Handelsman Shugerman, *Faithful Execution and Article II*, 132 HARV. L. REV. 2111 (2019).

[323] *See* Samuel L. Bray & Paul B. Miller, *Against Fiduciary Constitutionalism*, 106 VA. L. REV. 1479 (2020).

[324] *See, e.g.*, sources cited *supra* note 318.

[325] *See supra* Section I.C.

[326] *See supra* Section II.B; *supra* note 20 (explaining that contract is a creature of law, so in order to find whether something is a contract, we must turn to the legal framework that gives rise to that instrument).

[327] On the fundamental nature of contract law as grounded in the ex ante dimension (and being incompatible with ex post judicial supervision of the kind prevalent in corporate law),

intervention.

To see this, one need only examine several decisions cited in *Salzberg*,[328] the most recent Delaware Supreme Court case on the nature of corporate charters and bylaws. The *Salzberg* court quotes a decision stating that "[a]t its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial private ordering, *provided the statutory parameters and judicially imposed principles of fiduciary duty are honored*."[329] Another decision is cited as saying that "Delaware's corporate statute . . . leaves the parties . . . with great leeway to structure their relations, *subject to* . . . *the policing of director misconduct through equitable review*."[330] Once again: "[forum selection clauses should be] den[ied] enforcement . . . to the limited extent necessary *to avoid some fundamentally inequitable result*."[331] Other cases emphasize the same.[332]

This regime of ex post judicial modification is not "contract," and by definition, it cannot be.[333] Instead, what the Delaware courts are talking about

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see ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC, 50 A.3d 434, 440 (Del. Ch. 2012).

[328] Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020). For discussion of the case, see *supra* Section I.B.

[329] *Salzberg*, 227 A.3d at 116 (emphasis added) (quoting Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996)).

[330] *Salzberg*, 227 A.3d at 116 (emphasis added) (quoting Jones Apparel Grp., Inc. v. Maxwell Shoe Co., Inc., 883 A.2d 837, 845 (Del. Ch. 2004)).

[331] *Salzberg*, 227 A.3d at 132 (emphasis added) (quoting Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 949 (Del. Ch. 2013)).

[332] *See, e.g.*, Lacey v. Larrea Mota Velasco, C.A. No. 2019-0312-SG, 2021 Del. Ch. LEXIS 25, at *3-18 (Del. Ch. Feb. 11, 2021) ("[T]he entity and its directors are not contractually bound to one another by the charter—they are not counter-parties—and the legal compulsion for directors to comply with the charter arises as part of their fiduciary duties, and not in contract. . . . The relationship between directors and their corporation is typically fiduciary, rather than contractual, and if any claim is created *on behalf of the corporation* by a failure on the part of directors to comply with the entity's formative documents, it is a claim for *breach of fiduciary duty*." (footnote omitted)); *In re* Viacom Inc. Stockholders Litig., Consol. C.A. No. 2019-0948-JRS, 2020 Del. Ch. LEXIS 373, at *3 (Del. Ch. Dec. 29, 2020) ("[In] courts of equity, . . . judicial review of fiduciary conduct abides . . . ."); Sample v. Morgan, 914 A.2d 647, 664 (Del. Ch. 2007) ("An essential aspect of our form of corporate law is the balance between law . . . and equity . . . . Stockholders can entrust directors with broad legal authority precisely because they know that that authority must be exercised consistently with equitable principles . . . .").

[333] *See supra* Section II.B; *supra* note 327.

is *the structure of corporate law*, as a self-standing legal category. They are essentially saying this: when a given act—by directors, officers, or any other person subject to the norms of corporate law—comports with the building blocks of corporate law (among them equity and fiduciary duty),[334] we are likely to approve that act after-the-fact. While doing so, we will sometimes *also* mention that an "event of volition" on the part of *some* shareholders, or the corporate entity (say, a vote to amend the corporate charter), took place, *if* it did, which is not always the case. This is where we use the word "contract," mainly for lack of more nuanced terminology—perhaps a long-term effect of legal realism's disdain for legal concepts.[335] This is the space in which the "ex ante corporate governance movement"[336] has been operating, and should continue to operate.

Even when these scattered instances of volition occur, however, they do not rise to the level of "consent," and do not turn corporate law into contract law. If the act at issue does *not* align with our equitable principles—and, given the open-ended power which corporate law uniquely confers upon the entity and its fiduciaries,[337] some acts will inevitably end up in that basket—we shall deem the act inequitable, and thus impermissible;[338] any purported ex ante "consent" will not change this result.

Therefore, contrary to some commentators' well-motivated concerns,[339] a close reading of Delaware case law does *not* lend support to a "contractarian" view of the corporation. The exact opposite is true: at every turn, corporate actors rely on ex post adjudication to remedy violations, deter misconduct, and reduce power and information asymmetries. When faced with the question of mandatory arbitration in corporate law, the federal courts will have to carefully examine these cases—the original Archimedean point from which corporate law emanates, and based on which the federal courts must determine its nature.[340] Even if, occasionally, a case uses the word "contract"

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334 *See* Raz, *supra* note 34, at 545-46, 557-66.

335 *See, e.g.*, *supra* note 2 and accompanying text.

336 Shaner, *supra* note 73, at 1040.

337 *See supra* Section II.B.

338 *See* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible.").

339 *See, e.g.*, Lipton, *supra* note 12, at 641 ("By justifying fee-shifting bylaws and forum selection clauses as contractual, Delaware may have triggered an unintended consequence in opening the door to mandatory arbitration . . . .").

340 *See supra* notes 126-27 and accompanying text.

without following it with a discussion of equity and ex post review,[341] this does not detract from the many cases that do.[342] Corporate law should be treated as a whole. A judge (and certainly a textualist judge) is not at liberty to read one part of the sentence—"contract"—and skip the other part—"non-contractual, ex post supervision, grounded in equity and in the structure of corporate law."

When we turn to the story of "contract" in corporate law *scholarship*, things get even more interesting. Since the 1970s, and particularly following Professors Michael Jensen and William Meckling's description of the corporation as "a nexus for contracting relationships,"[343] corporate law academics—especially within the dominant law and economics movement—have been keen on using a language of "contract" when discussing innumerable, ever-changing topics in corporate law.[344]

Yet, there is an apparent irony here: more often than not, these law and economics scholars belong to the shareholderist camp, advocating both shareholder wealth maximization (as the *end*) and shareholder empowerment (as the *means*) in corporate law.[345] The highly influential corporate governance movement,[346] which has expanded to global proportions,[347] largely rests on these premises. The legal concept of contract, however, is strongly antithetical to advancing shareholders' rights.

After all, if the corporate "contract" is the corporation's charter and bylaws; if contract law is an ex ante regime, where contracts are to be enforced according to their existing terms;[348] and if directors and officers (shareholders' arch-rivals under the "agency costs" theory that dominates corporate economic

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[341] *See, e.g.*, sources cited *supra* note 318.

[342] *See, e.g.*, sources cited *supra* notes 329-32.

[343] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976).

[344] *See, e.g.*, William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989) (surveying the early development of this usage); sources cited *supra* note 3.

[345] *See, e.g.*, Raz, *supra* note 34, at 527-28, 567 (discussing shareholderism and some scholarly works advocating it).

[346] *See, e.g.*, Pargendler, *supra* note 16.

[347] *See, e.g.*, Mariana Pargendler, *The Rise of International Corporate Law* (Eur. Corp. Governance Inst., Working Paper No. 555, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3728650.

[348] *See supra* Section II.B.

scholarship)[349] can both dictate the terms of charters and bylaws,[350] and run nearly every other aspect of the corporation[351]—then "contract" as such cannot possibly be beneficial for shareholders. Mandatory arbitration, of course, provides the clearest example.[352] To protect shareholder interests, there must be some framework *other* than contract at play, and indeed there is: corporate law. In practice, the leading economic works debate the merits of various non-contractual, corporate-specific legal devices, grounded in equity, fiduciary duties, and legislative and judicial lawmaking to protect asymmetrically-positioned parties.[353]

How, then, can the widespread use of the phrase "contract" in corporate scholarly circles be explained? There are at least two plausible answers. First, it is likely that some law-and-economists, deeply influenced by the tradition of legal realism,[354] do not pay sufficient attention to legal concepts and categories—especially when it comes to corporate law, which suffers from a "low-visibility problem" at the outset.[355] While the *substance* of these authors' scholarship deals with corporate law *as corporate law*, the *language* they employ turns to "contract." In any case, the mere use of a word cannot override the legal norms and structures that define what is required to form a contract (ex ante consent to specific promises), and what corporate law is about (ex post supervision over open-ended adventures), making the two areas inherently differ from one another.[356]

The second explanation involves an intriguing bit of history. It comes from new research by Professor David Gindis.[357] As Gindis reveals, Jensen and Meckling chose to highlight the term "contract" in their 1976 article[358] as a

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[349] *See, e.g.*, Heaton, *supra* note 31.

[350] *See supra* notes 175-80 and accompanying text.

[351] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2020) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

[352] *See supra* Section I.C.

[353] *See, e.g.*, sources cited *supra* notes 242-44.

[354] *See* Smith, *supra* note 4, at 46-48.

[355] *See supra* text accompanying notes 26-36.

[356] *See supra* Section II.B.

[357] David Gindis, *On the Origins, Meaning and Influence of Jensen and Meckling's Definition of the Firm*, 72 OXFORD ECON. PAPERS 966 (2020).

[358] Jensen & Meckling, *supra* note 343.

response to a broader social and political controversy going on at the time. That debate concerned the proper role of corporations in society: should they only serve shareholder interests, or should they operate in the benefit of other stakeholders, including employees and consumers.[359] This is the same topic that has resurfaced over the last couple of years.[360] In the vocabulary of the 1970s, Jensen and Meckling believed that stressing a "contractual" view of the firm, as opposed to it being a creature of the state, would support the shareholderist argument.[361]

Today, however, we know that this particular dispute—between the lawful pursuit of wealth and stakeholder orientation—lies on a separate axis from the debate concerning the rights and duties of the corporate entity, its shareholders, and its fiduciaries vis-à-vis one another. Put simply, there is no need to invoke the word "contract" to defend a lawful profit-seeking view of the corporation.[362] More accurately, Jensen and Meckling (just like present-day law and economics scholars) could have said that the corporation is *a creature of private law*—which includes, in addition to contract, the fields of property, tort, and corporate law, among others.[363] In each of these, the actors are private. The state serves in a *legislative* and *adjudicative* capacity, but is not itself a party (a right-and-duty bearer) within the private law relationship.[364]

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[359] *See* Gindis, *supra* note 357, at 973-76.

[360] *See supra* note 49.

[361] *See* Gindis, *supra* note 357, at 980-81 ("[Jensen and Meckling's] definition makes sense once the socio-political context within which [their 1976 article] was written is taken into account. . . . [W]hen Jensen and Meckling got immersed in the public debate about corporate responsibility and regulation in the late 1970s and early 1980s, their message that private corporations were unlikely to survive additional regulatory burdens followed from their definition of the firm.").

[362] An earlier article demonstrates that, while corporate law has a legally-prescribed structure, and strongly diverges from contract law, it also mandates that the purpose of for-profit corporations is the lawful pursuit of profit. *See* Raz, *supra* note 34.

[363] *See, e.g.*, THE OXFORD HANDBOOK OF THE NEW PRIVATE LAW (Andrew S. Gold, John C.P. Goldberg, Daniel B. Kelly, Emily L. Sherwin & Henry E. Smith eds., 2020) (including chapters on each of these fields and many others).

[364] *See, e.g.*, John C.P. Goldberg, *Introduction: Pragmatism and Private Law*, 125 HARV. L. REV. 1640, 1640 (2012) ("Private law is law, so government is involved, *albeit in a particular way*." (emphasis added)); Raz, *supra* note 34, at 576 nn.284-85. Indeed, commentators who cling to a vision of the corporation as "a creature of the state," often relying on cases such as *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819), and echoing the "concession theory" of corporate law, are equally as mistaken as the contractarians. The former tend to underappreciate the effect of general incorporation, *see supra* note 291. That reform has modified the state's role in corporate law, from a right-and-duty bearing actor to a law-making and law-enforcing one—just as it is in

To meaningfully create and enforce certain rights—including those of the shareholders Jensen and Meckling sought to defend—the legal (and economic) framework must *differ* from contract.[365]

Given that Jensen and Meckling came from a background of economic, not legal, scholarship (combined with the influence of legal realism, discussed above), there was scant chance they would take this simple, but profound, step. They settled for "contract," intending to address a completely different problem from the present one, in which pro-arbitration advocates will seek to leverage a misconstrued "contract" terminology to collapse corporate law's enforceability, allowing disloyal actors to place themselves beyond the reach of legal remedy.[366] This is a far cry from what law-and-economists, from Jensen and Meckling to the present day, have been aiming for.

When the question of mandatory arbitration in corporate law reaches the federal courts in full force, in addition to the *substantive* and *functional* inquiry offered in Section II.B, they should remain mindful of this Section's linguistic analysis—demonstrating the exceptionally qualified, metaphorical, and historically circumscribed way in which both state courts, and members of the scholarly community, have used the word "contract" in the corporate law context.

CONCLUSION

A storm is brewing on the corporate law horizon. A series of recent events, which this Article ties together for the first time—namely, the *Johnson & Johnson* case pending in federal court, and the Delaware Supreme Court's recent *Salzberg* decision—raise the possibility that, in the near future, large swaths of U.S. corporate law would become unenforceable, placed beyond the reach of any court or other remedial mechanism.

This would happen if the federal courts—possibly as high as the Supreme Court—choose to authorize the enforcement of mandatory arbitration clauses in corporate charters and bylaws. Such provisions would then be unilaterally imposed by corporate directors and officers—the very same people whom litigation in open court is meant to supervise—and, due to the Supreme Court's expansive arbitration jurisprudence, would eliminate any chance for corporations and shareholders to challenge both the arbitration

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other areas of private law. The *content* of each private law framework (contract, property, corporate, and so on) is different, but the state's role is similar.

[365] *See supra* Section II.B.

[366] *See supra* Section I.C.

clause itself, and *any* act of misconduct by directors, officers, and other corporate law actors, however egregious or harmful.

Although it is likely that not all corporations will become subject to mandatory arbitration, the corporations *most* likely to suffer from such justice-impeding provisions are the ones where wrongdoing is more likely to occur in the first place. In practice, such arbitration terms are precisely equivalent to a waiver of all fiduciary and equitable duties within the corporate relationship—a waiver which Delaware law has long prohibited, even outside of the arbitration context. Part I describes in detail this new trajectory U.S. corporate law might soon embark on.

Will mandatory arbitration in corporate law actually happen? According to the Federal Arbitration Act itself, and ample precedent from the Supreme Court, this troubling move hinges upon one preliminary finding: that corporate charters and bylaws are "contracts." As this Article explains in Part II, such a determination cannot be made consistent with law. Under the influence of legal realism, scholars have long been reluctant to discuss the *legal* structure of corporate law, and the boundary separating it from other frameworks, most importantly, contract law. As this Article originally demonstrates, if we bring corporate law in line with the newest private law scholarship, while taking a moment to consider corporate law *as law*, we find that corporate law is not merely different, but in some respects the opposite of contract law.

Just like other areas of private law, including contract and property, have an underlying theme, corporate law has its *open-endedness principle*: it is about what happens after-the-fact. Corporate law generates extremely little information ex ante, and vests the corporate entity with the power to go on unpredictable adventures (think Google or SpaceX), premised on the concepts of corporate personhood, the "any lawful act or activity" statutory language, perpetual existence, and the business judgment rule—all of them unique creatures of corporate law, not encountered in any other framework, least of all contract.

While contract law is about promises made before-the-fact, and enforceable according to their pre-defined terms, corporate law disciplines its actors through ex post devices: the law of corporate purpose, equitable remedies, and fiduciary duties. Corporate law's non-contractual nature thus encourages innovation, entrepreneurship, and risk-taking, while keeping corporations and their fiduciaries within enforceable legal constraints. The majority of corporate law cases are variations on this basic theme: freedom of action, combined with ex post enforcement to remedy and deter wrongdoing. What corporations can do is open-ended and permissive; *corporate law* itself is not. If there is anything remotely approaching an act of "consent" by corporations and shareholders, it is *to enter the structure* of corporate law, where they are protected by these non-contractual devices.

This Article has shown that the Realist-inspired “contract” metaphor cannot substitute for a serious, methodical analysis of what corporate law is, what makes it distinct from other legal frameworks, and how its unique building blocks support economic progress and innovation in modern society. Facing the specter of mandatory arbitration, even economically-minded scholars should pay attention to the *legal* taxonomies upon which the future of corporate governance hinges. Following the developments examined in this Article, federal courts will soon be asked to decide whether to allow corporate law actors to place themselves beyond the reach of enforceable law, through the use of mandatory arbitration clauses. According to the Federal Arbitration Act and the Supreme Court’s precedents—combined with the diverging, almost polar, concepts of corporation and contract under state law—there is no basis for doing so. If we accept that it is possible for *some* legal concepts to *not* be contracts (which even the most market-oriented lawmakers and scholars would admit), then corporate law, and the instruments it gives rise to—corporate charters and bylaws—top that list.