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CORPORATE LAW AS A FACILITATOR OF SELF GOVERNANCE

Edward Rock* and Michael Wachter**

A few years ago, we began working on a series of articles that brought together our separate research agendas. We found a natural resemblance between two seemingly different approaches. One of us, Professor Edward Rock, has argued that a distinctive quality of Delaware fiduciary duty law is that it fits poorly into a rule-oriented approach.\(^1\) Instead, Professor Rock argued, one should think of fiduciary duty cases as judicial sermons that exhort managers to consummate performance and that criticize those who perform below expectations, even if, or perhaps especially when, no direct legal sanction is imposed.\(^2\) The conclusion was the message that "legal sanctions were little more than place-holders for the accumulation of the messages."\(^3\)

Professor Michael Wachter, working jointly with others, had argued that inside the firm the actors protect the integrity of their relationships on their own, eschewing the protections of legal sanctions. Rather than relying on costly contract-writing that would be enforced by third parties, the actors adopt arrangements that are self-enforcing. Tied to the theory of the firm, one lesson was that the relationships that are brought inside the firm are precisely those relationships that are less expensively governed by self-enforcing arrangements.\(^4\)

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\(^2\) Id. at 1015.
\(^3\) Id. at 1016.
In retrospect, those articles were part of a different discussion. They were an attempt to understand the role of non-legally enforced norms in corporate law on the one hand and in employment relationships in the firm on the other. The resemblance between our previously distinct lines of research runs deep. In a series of joint papers, we have considered the relationship between law and norms in corporation law, and recently we have developed a more general theory that brings together corporation law and the theory of the firm. In this Essay, we outline briefly this general theory, which we are developing in more detail elsewhere, and discuss how embracing this approach would affect the way one teaches the basic Corporations course. In this general theory, we try to bring together property rights and transaction cost theories of the firm with the norms literature to recast our understanding of the fundamental structure of corporate law.

We begin with what we consider to be the standard view. In the standard approach, one tells one’s students that the corporate form has four characteristics: limited liability for investors, free transferability of investments, legal personality, and centralized management. This ordering of the characteristics, more often than not, conveys their relative importance. If one views the corporation as a nexus of contracts, the shareholder/firm nexus is the focus of corporation law. Limited liability, free transferability, and to a lesser extent, legal personality, establish the contours of the shareholders’ “contract” with the firm. The design of corporation law is then to minimize both the agency costs between shareholders and managers, by bringing their interests into alignment, and the collective action problems that arise when shares are widely held.

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and which make it difficult for shareholders to minimize agency costs. If one takes this view, much of corporation law can be understood as a solution to one or another of these problems. Professor Rock formerly took this approach and, in doing so, was clearly not alone.

Our approach breaches with this tradition. As we discuss below, if the four characteristics of the corporate form are ranked in terms of their importance, centralized management becomes the first rather than the last of the four. This shift has fundamental implications for how one understands and teaches corporate law.

I. THEORIES OF THE FIRM

A theory of the firm—by describing why we have firms, what goes on inside firms, and what are the boundaries of the firm—helps us identify the key problems that parties to the firm need to solve. A theory of the firm can also help us figure out what problems the parties are able to solve themselves, how they solve them, and the role the law plays in facilitating solutions or in interfering with solutions.

Three competing theories of the firm have been developed and refined over the past several decades. While not mutually exclusive, each has had different implications for corporate law. For the last fifteen years, most scholars who addressed the connection between the theory of the firm and corporate law focused primarily on the agency cost theories of the firm associated with Alchian and Demsetz and with Jensen and Meckling. Agency cost theories of the firm, however, are incomplete in four important dimensions. First, they provide no theory of the boundary between the firm and the market. Second, agency cost theories provide no explanation of the "core" of the firm, that which allows the firm to thrive in competitive product markets. Third, at least as applied in corporate law, these theories focus too much on the isolated contracting node

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of the firm, failing to place it in the broader operational context in which the firm operates. In so doing, the theories fail to identify the reasons that centralized management is central. Finally, they fail to differentiate between legally enforceable provisions and non-legally enforceable norms.

In the years since Jensen and Meckling, a complementary "property rights" approach has been developed, primarily by Grossman, Hart and Moore, which helps explicate the firm's "core." At the same time, over a somewhat longer period, the transaction cost theories of the firm, largely associated with Oliver Williamson, have focused on the firm-market boundary. In our working paper, we set forth a view of the firm that draws on and extends these two literatures, and looks at the connection between these property rights theories and understanding corporate law.

We take the firm to be a locus of specific investment in which transaction costs are sufficiently high that contractual incompleteness is inevitable. In this picture of the firm, several overlapping features emerge as particularly significant.

First, at the core of the firm are its physical and intangible assets. These assets are owned by the firm in that the firm has residual control rights and can allow or deny access to them. Many of these assets are specific to the firm and, given their uniqueness, provide the firm with whatever competitive advantages it enjoys. For the corporation to succeed in maximizing free cash flow, it must purchase assets required to maintain its competitive advantage while shedding those that are not needed.

Second, employees are given access to selected assets, and many make match-investments in the individualized assets with which they work. The difference between employees and the outside suppliers and customers, who may also work with or around the firm's assets, is that the employment relationship is brought inside the firm, thereby marking the firm's boundaries. Asymmetry of information abounds, primarily but not entirely due to asset

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specificity. This circumstance requires a mechanism that protects the corporation's, the suppliers', and the employees' investments in match assets.

Third, the distinguishing feature of the activities brought inside the firm is that the intra-firm activities are marked by numerous and recurring transactions over an indeterminate period of time. In this environment, contracting within the firm is necessarily incomplete, with the result that a noncontractual governance system must be adopted to protect the integrity of the transactions between the employees and the firm (and to a lesser extent between the suppliers and customers and the firm). In deciding which assets to buy, which employees to assign to specific assets, and which relationships to bring inside the firm, the firm relies on centralized management.

Under these conditions, a set of governance problems must be solved in order to produce widgets optimally and to maximize the free cash flow available to shareholders. First, property rights—defined here as the power to determine access to specific assets and the residual power of control—must be assigned. Second, the potential for opportunism that always arises from investments in specific assets must be controlled. This opportunism can arise in three different contexts. The critical employee may threaten to leave with key information still in his head; the firm may threaten to fire a key employee once he has transferred the information in his head to the firm; or, finally, controlling shareholders may threaten to mistreat non-controlling shareholders. The governance structure, while minimizing agency costs, must also solve the operational problem of maximizing free cash flow. Taking all this to be true, the question becomes what does this tell us, first, about corporate law, and, derivatively, about how to teach corporate law?

II. THE PRINCIPAL IMPLICATIONS FOR CORPORATE LAW

In this section, we outline, without fully defending, what we take to be the principal implication of the preceding view of the firm for
corporate law. This discussion is only a summary. For a full
defense, we refer people to our working paper.12

First, relationships within the firm will largely be governed by
norms rather than law. Here, by “norms,” we mean “non-legally
enforceable rules or standards.” In our working paper, we propose
the acronym NLERS, in order to avoid confusion with the variety of
other meanings of the term “norm.” In relationships governed by
NLERS, understanding the role of the law is tricky. In an NLERS
world, the private actors create and enforce most of the rules. One
must thus explore the extent to which the law facilitates or
undermines the establishment and maintenance of NLERS
governance.

Second, the corporate form itself—typically chosen by both
publicly held and closely held firms—sets up a remarkably robust,
“incentive compatible,” self-enforcing solution to the problems that
the firm must solve. This form goes a long way toward creating an
environment for NLERS governance.

Because the corporation is a legal person, it can hold property.
By providing that the business and affairs of the corporation will be
managed by or under the direction of the board of directors13 and
that directors will be elected by the shareholders,14 the Delaware
statute creates centralized management. In so doing, it assigns to
central management the right to determine the optimal asset set
and the utilization of those assets in order to maximize the corpora-
tion’s value. Stockholders vote on extraordinary asset purchases or
sales and on mergers, but not on the ordinary operating decisions.

These two features thus define, assign, and centralize the core
property and control rights. Without these features, firms could not
succeed. Every type of governance problem would emerge, from
decisions on how to attract and retain individuals willing to work
with specific assets, to questions of direction and coordination of the
work to be done. In fact, however, these problems rarely emerge.
Instead, the governance system with respect to physical and
intangible investments works so well that we often neglect to credit

12 Rock & Wachtler, supra note 7.
13 DEL. CODE ANN. tit. 8, § 141(a) (1998)
14 Id. § 211 (1998).
its accomplishment. By creating the foundations for the firm to operate under centralized management, corporate law answers the question of who gets to "run" the company.

The corporate form resolves other governance questions as well. By providing the firm with an indefinite term of operations, this form solves problems involving opportunism that arise in the last period. Because dissolution requires a board resolution and a vote of a majority of the shares, individual minority shareholders have no power to trigger dissolution. Minority shareholders likewise have no right to be bought out because, under the standard corporation laws, no shareholder has a general right to be bought out. This prevents any individual non-controlling shareholder from threatening dissolution in order to increase his share of the surplus.

Similarly, the corporate form handles potential opportunism by the controlling shareholders toward the non-controlling shareholders. Here the critical mechanism is the prohibition on non-pro-rata distributions. Dividends—by definition—must be paid pro rata. Upon dissolution, anything left after creditors are paid off is distributed pro rata to the shareholders. These terms provide a first-order solution to majority opportunism by yoking the interests of the controlling shareholder to those of the minority. So long as non-pro-rata distributions are prevented, the controlling shareholder, in maximizing the value of his stake, likewise maximizes the value of the minority shares. If the controlling shareholder wants to get money out of the firm, minority shareholders receive their cut as well, either through dividends or upon dissolution of the firm.

It is also clear why these terms must be legal terms. The legal forms efficiently provide the initial default settings, allowing the parties to choose easily between centralized and decentralized management. Moreover, once the firm gets started and especially in the last period, gains from opportunism can be very large, whether in the form of the controlling shareholder stealing from the firm or the minority shareholder holding up the controlling shareholder. Socially acceptable NLERS sanctions may not be sufficiently robust to constrain such behavior.

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15 Id. § 281.
Finally, on this view of corporate law, fiduciary duties play quite an interesting role that is not generally recognized. In understanding the role of fiduciary duties, three goals must be kept in mind. First, the key coordinating function served by centralized management must be preserved. Second, both minority and majority opportunism must be discouraged. Third, the self-governing character of the relationship must be preserved.

III. THE DUTY OF LOYALTY

The duty of loyalty is the second half of the prohibition on non-pro-rata distributions. The first piece, mentioned above, is the statutory requirement that dividends be paid out pro rata according to the number of shares, with the linked requirement that upon dissolution, all shareholders share pro rata. But there are a multitude of ways to evade such a rule. The role of the duty of loyalty is to provide an *ex post* check, to prevent enough instances of self-dealing from slipping through so that the overall incentive compatibility of the form is preserved. The form maintains its usefulness if some self-dealing gets through, but not if too much does.

Each of the major aspects of the duty of loyalty blocks one of the most obvious modes of siphoning off assets. The limitations on basic self-dealing attempt to prevent the grossest sorts of theft, while encouraging the use of processes that will preserve enough flexibility to permit transactions that will benefit the firm. The treatment of compensation, similarly, is understood as a judicial attempt to prevent the worst sorts of self-dealing, while allowing enough flexibility in structuring compensation so as to encourage managers to perform well. Finally, the various strands of the corporate opportunity doctrine seek to strike a similar balance.

As such, the role of the duty of loyalty is to provide a check on majority opportunism. Because of the gains available to the majority from stealing, the check must be legal. But, at the same time, the check is constrained. The idea is to keep the controlling shareholder in the flock, working for the advantage of the group. The law plays the role of sheep dog, but does not intervene beyond what is necessary.
From this perspective, the duty of care and the business judgment rule are more remarkable. The duty of care is typically taken to be some sort of negligence rule, which is operationalized through the business judgment rule. The puzzle posed by the duty of care is that if it is a negligence rule, why are findings of negligence so much less common than in other cases of professional malpractice?\(^\text{16}\)

In our view, the difference lies in the context in which the parties establish their relationships. Corporate decisionmaking is NLERS-governed while medical malpractice law and other professional malpractice is and typically must be law-governed. To unpack this claim, it is useful to proceed in several steps.

First, medical malpractice in particular, and negligence in general, represent the use of legal sanctions to control conduct. NLERS governance is unlikely to work in the typical negligence context because the interaction among the parties is typically one shot, with no opportunity to negotiate terms. In the medical malpractice context, while there may be some opportunity to negotiate terms, the difference in knowledge between doctor and patient, the imperfections of the markets, and the magnitude of the harm are such that the opportunity to negotiate terms is limited. Again, the stakes are sufficiently high that NLERS are unlikely to suffice.

Directors and shareholders, by contrast, are in a continuous set of interactions. As argued above, and discussed in more detail in our working paper, the nature of the relationship between the parties and the density of match assets are such that it is in just such cases that NLERS governance is likely to trump law governance. Our argument, then, is that the difference between the directorial and the medical duty of care is not in the nature of the decisions—as Eisenberg suggests\(^\text{17}\)—but in the nature of the relationships among the actors.


\(^{17}\) Eisenberg, *supra* note 16.
From this perspective, the business judgment rule looks strikingly like the employment-at-will doctrine in employment law. It is a rule of judicial non-intervention. The boundary of the firm is both an economic and a jurisdictional boundary. Under the employment-at-will doctrine, an employer may discharge an employee for good reason, bad reason, or no reason at all. In other words, the courts are unwilling to rule on the reasons for discharge, leaving it to the parties to work out. Similarly, in the corporate context, the actual standard of review applied by courts to corporate decisionmaking can generally be described as no liability for negligent decisionmaking absent self-dealing.

Understood this way, the business judgment rule serves several purposes by preventing non-controlling shareholders from complaining to a third party about the business decisions of central managers. First, intervention by third parties interferes with centralized management. Second, the ability to appeal to a third party provides a tool that can be used strategically by minority shareholders. Third, the ability to appeal to a third party undermines the self-governing quality of the relationship. As such, the business judgment rule is about preserving centralized management, preventing minority opportunism, and preserving NLERS governance.

V. THE LIMITS OF NLERS SELF GOVERNANCE

The truly interesting cases are those in which the court refuses to apply the business judgment rule because of “gross negligence,” as in Smith v. Van Gorkom, or because a number of the directors fail to satisfy the independence requirement, as in Cede & Co. v. Technicolor. What are the courts doing when they seem to demand that the board follow a particular process or methodology?

One approach is to view these cases as cases of suspected self-dealing, in which bad process is viewed as a red flag indicating self-

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19 488 A.2d 858 (Del. 1985).
20 634 A.2d 345 (Del.), modified, 636 A.2d 956 (Del. 1994).
dealing even if there is no good evidence of self dealing in the record. Read this way, these cases really become an appendix to the self-dealing doctrines of the duty of loyalty.

The opinions do not read this way, however. In reading either *Van Gorkom* or *Cede*, one has little sense that the judges, both on the Delaware Court of Chancery and the Delaware Supreme Court, think that self-dealing is going on. They are offended by something else. In the case of *Van Gorkom*, they seem to be offended by Van Gorkom acting in a headstrong, imperious way, pushing through the deal without following appropriate process. Similarly, in *Cede*, the Delaware Supreme Court is bothered both by Chancellor Allen’s analysis and application of the duty of care as a negligence rule, and by the presence of a director who received a (disclosed) finder’s fee in connection with the transaction.

The better reading of these cases is that judicial scrutiny is appropriate because selling the company puts the directors into the “last period” of play. Like the self-dealing cases, these cases stand for the proposition that NLERS self-governance potentially breaks down in the last period of play, and therefore the courts have to scrutinize the behavior and results carefully (which they call “entire fairness” scrutiny).

VI. THE COURTS AND THE TRANSMISSION OF NLERS: STORIES ABOUT SAINTS AND SINNERS

This analysis brings us to the question of how NLERS are transmitted and what role, if any, Delaware judges play in that process. The first, and clearly most important, transmission device for NLERS is competitive markets. While centralized management will, in the first instance, choose the NLERS for the firm, this is done against the background of a market check. Beyond competitive markets, there are a variety of transmission mechanisms. Business schools and consultants play a significant role. Directors who serve on more than one board can act to cross-fertilize. Lawyers likewise

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21 *Van Gorkom*, 488 A.2d at 866-69.
22 *Cede*, 634 A.2d at 368-69.
often see a wide range of variations and develop notions of best practice.

Where do the Delaware judges fit in here? If one takes management buyouts (MBOs) of large, publicly held corporations as an example, one finds that the use of a special committee, while clearly recommended by the Delaware courts—and a largely accepted practice—is neither necessary nor sufficient for the validity of the transaction. Thus, it seems to be an NLERS. The Delaware courts, during the 1980s, played a central role in articulating and encouraging the use of special committees in MBO transactions, often by criticizing or complimenting particular lawyers and directors without imposing any sanction.\(^\text{23}\)

Similarly, Delaware's encouragement of the use of independent directors in conflict transactions, although again neither necessary nor sufficient, can likewise be understood as an effort to spread the emerging best practice. In that context, indeed, the Delaware courts' role may be to spread best practice among companies and, especially, from large companies to smaller ones.

In both cases, if the Delaware courts are, indeed, playing a role in the transmission of NLERS, they are doing so within a narrow compass. The NLERS they encourage are within the scope of lawyers' traditional expertise: process-based, institutionally subtle governance mechanisms designed to control complicated conflicts of interest. Judges typically drawn from the Delaware corporate bar—or, when not, rather quickly socialized by those who were—occupy an odd sort of insider-outsider position. From years of corporate practice, they typically know much about the way the corporate world works. But, at the same time, they develop a sense of the limitations of the judicial role, especially with respect to encouraging excellent management or punishing bad management. This perspective puts them in the position of having at least some credibility to influence this specialized set of NLERS, especially in publicly held corporations, through criticism unaccompanied by legal sanction.

Because they are encouraging the development of NLERS, however, these judges do not do so by the straightforward applica-

\(^{23}\) Rock, *supra* note 1, at 1103-04.
tion of legal sanctions. Rather, the possibility of intrusive scrutiny provides the incentive for the development or internalization of appropriate modes of behavior, coupled with the withering denunciations of self-dealing that courts are capable of delivering.

Here we find a dual explanation for the peculiar quality of Delaware case law. First, the judges are insiders and thus recognize and feel confident about condemning bad behavior in strong terms. Second, judges function in, and deeply respect, the NLERS self-governance of the corporation, and thus are reluctant to disturb it. Put these two factors together, and you predict vigorous criticism unaccompanied by legal sanctions.

*Van Gorkom* provides a wonderful case to examine the conflicts that can emerge when case law is operating at the boundary between legally enforceable and non-legally enforceable rules and standards. In finding directors personally liable for selling Trans Union at a price far above the pre-deal stock price, but with minimal process, the Delaware Supreme Court appeared to expand the scope over which it would find violations of the duty of care and second-guess corporate decisions. By appearing to have upset the balance between self-governance and legal enforceability, the decision led to widespread criticism, ending with an amendment to the Delaware statute, section 102(b)(7). This amendment, by permitting corporations to opt out of liability for breaches of the duty of care, re-established the pre-existing structure in which the duty of care was almost entirely enforced by non-legal sanctions and, when enforced by legal sanctions, by equitable relief. From a legal centrist viewpoint, the impact of the case is unclear: the case might be understood to have increased the standard of care, but, by limiting liability, to have decreased the cost of violations.

The actual legacy of the case, however, seems to have been quite different. Although the court was sketchy in describing the error committed by the directors in *Van Gorkom*, a more deliberate process was quickly incorporated into the prevailing NLERS. Regardless of whether the court was correct that *Van Gorkom* and the other defendants behaved with gross negligence, the effect of the

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24 *Van Gorkom*, 488 A.2d at 893.
case seems to have been to improve the quality of boardroom decisionmaking in control transactions. If our reasoning is correct, the court might well have achieved the same result by describing the behavior of the defendants in strongly judgmental tones, while holding that the business judgment rule protected the decision.26

VII. IMPLICATIONS FOR TEACHING THE BASIC COURSE

If one shares our view of corporate law, how does it affect the way one teaches the basic course? There are several implications.

First, one can spend some time talking about the theories of the firm. Why are there firms? What explains the core? What explains the boundaries? What are the problems that a firm must solve to accomplish its objectives, namely, to achieve some competitive advantage? Why do firms choose one particular legal form over another? The answers to these questions help anchor the course in the competitive market realities that corporations face.

An agency-centric theory of corporation law has a good deal to say but its picture is incomplete and distorted, at least in part because directors are not agents of the shareholders in the legal sense. If students learn agency theory “too well” in an introductory section, they will be puzzled to learn that the business and affairs of the corporation are managed by or under the direction of a board of directors, who, in turn, appoint the executive officers of the corporation. Although shareholders get to vote, absent a battle for control, they get to vote on very few matters of substance. Upon further learning the difficulty that some shareholders face in seeking corporate information and in advancing by-law amendments, they might incorrectly conclude that most corporate shareholders would prefer to have more power to constrain the board than is provided to them under Delaware corporate law.

Indeed, the great mystery for those who look at corporate law through the agency-cost lens is why shareholders, the principals, have so little ability to constrain the managers, their agents. If

26 The settlement of the case meant that the Delaware Court of Chancery never returned to the question on remand.
students interpret the statute as embedding a theory of agency, they will either find the statute confusing or the theory mushy.

Property-rights and transaction cost theories help avoid this confusion by introducing the fundamental economic decisions corporations face, such as choosing their capital assets and determining the appropriate scope of vertical integration. Directors and their appointed executive officers run the corporation because doing so is much more likely to maximize profits. Transaction cost theories naturally lead to the conclusion that shareholders, if given the choice, would choose the corporate structure that exists in most state statutes. Students grounded in the full range of theories of the firm are more likely to appreciate that it is the requirements of centralized management that generate section 141 of the Delaware General Corporation Law and its progeny, and not some misguided failure to appreciate the possibility that managers’ interests may diverge from those of the shareholders.

Second, an introduction to alternative organizational forms is important. Although it is difficult to find the time in one semester, at least a brief introduction to the unique features of partnerships, limited partnerships, and close corporations opens the question of the environment in which each form is best suited.

Third, one needs to spend adequate class time on the core properties of the corporate form and how the form itself—the statutory settings—provides a robust first-order solution to the problems that must be solved. As part of this study, the comparison between the statutory form of the corporation and that of partnership emphasizes more the differences in centralized management and exit terms and only secondarily the difference in liability issues. Here, in particular, one wants to focus attention on the limitations on exit as a means to constrain minority opportunism. One also wants to focus attention on the limitations on non-pro-rata distributions as a means of controlling majority opportunism. However, in addition, students need to be chased around the statute, finding the statutory provisions that create the legal properties of the form. It is not enough for apprentice watchmakers to gaze on a watch with wonder; they need to learn how to take it apart and put it back together.
Fourth, one needs to address the boundary and balance between law and norms explicitly. One needs to introduce the concept of non-legally enforceable rules or standards, and show that important areas of economic activity are effectively governed by NLERS, and that, where it works, it is a better mode of governance than legal governance. This critical anti-“legal centrist” point is a very hard one to get across, especially to second-year law students who are imbued with the power and majesty of the law. We are not sure how best to make this concept clear to students. A starting point is a better appreciation of the role of transaction costs in determining which activities are best organized inside the firm and which are best to leave to the market. From this starting point, one can show why law works best outside the firm and NLERS governance works best inside.

Once one goes down this route, teaching fiduciary duties actually becomes much easier. The duty of loyalty cases are quite straightforward on this model: they are a backstop to enforce the statutory prohibition on non-pro-rata distributions that creates the beneficial lock-in. These cases must be legally enforceable rather than NLERS because self-dealing potentially transforms the relationship into a “last period” that the weaker NLERS sanctions, many of which depend on future interactions, cannot handle.

The duty of care-business judgment rule cases are more tricky and more interesting. The first point that must be made is that the business judgment rule is a jurisdictional rule. Here, the comparison with the employment-at-will doctrine is useful. Once one sees that the function of the business judgment rule is jurisdictional, one has an answer for why directorial malpractice looks so very different from other forms of professional malpractice. One also gets an answer to the question of why there is so little law in the duty of care context. The answer is that almost all of the duty of care is handled by NLERS.

At this point, one may want to spend some time talking about what the NLERS of the corporation are. The first and most important NLERS is “maximize firm value” and its variants. There are a myriad of ways that this is enforced, with essentially none of them being through the law. Making this point is important because it eliminates some of the confusion created by the “for whom
is the corporation managed?" cases, and the courts' unwillingness to intervene to punish stupid decisions (e.g., *Kamin v. American Express Co.*27) or to force the managers to profit-maximize. The key point here is that NLERS self-governance demands that the judges stay out.

One then gets to the cases exploring the limits of the business judgment rule. This examination takes one back to the limits of NLERS governance, namely, last periods. Self-dealing is one form of last period problem. Sale of the company is another. From this approach, what justifies the heightened scrutiny that one finds in cases like *Van Gorkom* and *Cede* is that, for example, Jerome Van Gorkom was in a last period, having decided to retire from the firm.

On this view, also, the common practice of spending an abundance of time in the basic course on the takeover cases is problematic because the last period problem makes them fundamentally different from other duty of care cases, such as *Kamin* and *Joy v. North.*28 One can fit the leading takeover cases into the overall structure by focusing on this aspect, which helps prevent the attempt that students typically make to transfer the doctrines of the takeover cases into non-takeover contexts. One can also use these cases—specifically the MBO cases in which criticism is leveled but often without the imposition of legal sanction—to illustrate the phenomenon of judicial participation in the evolution of NLERS.

Finally, with respect to derivative suits, one returns to the business judgment rule as a jurisdictional rule. The demand requirement begins to make a fair bit of sense. The question addressed by the demand requirement is whether there is reason to believe that the preconditions of NLERS self-governance have broken down sufficiently that judicial scrutiny is called for, not some odd sort of early summary judgment procedure.

Have we succeeded in transforming the basic course to comport with our view of corporate law as a system of norms? No, but this may be a start.

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28 692 F.2d 880, 897 (2d Cir. 1982).