

LESSONS TO BE LEARNED: HOW THE POLICY OF FREEDOM
TO CONTRACT IN DELAWARE'S ALTERNATIVE ENTITY LAW
MIGHT INFORM DELAWARE'S GENERAL CORPORATION LAW

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ABSTRACT

This article considers whether, as a result of recent activity by alternative entities in the public markets, it is appropriate to revise the Delaware General Corporation Law (DGCL) to provide for greater contractual flexibility to shareholders in all Delaware corporations. Such revisions may seek to alter or redefine the duties of directors and officers. Two situations presently call for contractual modification of managerial duties in public corporations: (1) aiding and abetting liability of advisors to exculpated directors, and (2) nonstockholder constituencies of Beneficial Corporations (B Corporations).

I. INTRODUCTION

As of 2008, an evolution in the choice of business entity for major organizations in the public capital markets is well underway. What historically was the sole domain of the public corporation is now sharing turf with public limited partnerships such as Blackstone Group, LP and public limited liability companies like Fortress Group, LLC.¹ The queries are simple: (1) why are investors opting for Delaware unincorporated entities rather than their corporate counterparts? and (2) why are these investors choosing Delaware?

The answer to the latter question appears clear—Delaware has long enjoyed a reputation for a sophisticated and expert judicial system and bar, modern and flexible business entity laws, a wealth of well-reasoned case law, and an efficient and user-friendly Office of the Secretary of State. Therefore,

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¹Recently, the Federal Reserve Bank of New York stated that it would form a Delaware limited liability company (LLC) to take over certain mortgage-backed securities and related hedge investments of Bear Stearns & Co. in an attempt to rescue Bear Stearns from bankruptcy. The assets in the Delaware LLC will be used as security for the \$29 billion loan the New York Federal Reserve Bank is making for the acquisition of Bear Stearns. The assets in the LLC will be sold over a period of time when the market is more advantageous. As to why the New York Federal Reserve Bank chose Delaware, speculation included comments like: "Businesses like Delaware because of the flexibility of its laws, the predictability of Delaware's Court of Chancery and Supreme Court and the sophistication of the judges." Maureen Milford, *Some of Bear Stearns' Assets Will Call Del. Home*, NEWS J., Apr. 3, 2008, at A1.

the significant inquiry is: what do Delaware alternative entities² offer that Delaware public corporations do not? The inquiry has a fourfold response.

First, alternative entities generally avoid entity level taxation.³ Second, Delaware alternative entities benefit from the contractual flexibility that permits sponsors to create a public entity and to install any managerial infrastructure desired.⁴ This internal contractual freedom also extends to the ability of investors to craft noneconomic ownership interests⁵ or to eliminate all voting rights if preferred.⁶ Third, public alternative entities are subject to different rules and regulations than corporations under the stock exchanges as well as the federal securities laws—rules that affect the internal governance of an entity.⁷ Fourth, and most unique to Delaware, in 1990, 1992, and 2004,

²In Delaware the term "alternative entity" refers to those business organizations that are: (1) not incorporated; and (2) historically contractual, rather than statutory or regulatory, in nature. According to this definition, Delaware's alternative entities include partnerships, limited liability partnerships (LLPs), limited partnerships (LPs), limited liability limited partnerships (LLLPs), LLCs, statutory trusts, and uniform unincorporated associations.

A corporation, on the other hand, has the historical roots of being chartered by the monarchy for colonial ventures. 1 STEWART KYD, A TREATISE ON THE LAW OF CORPORATIONS 40 (1978). In this manner, the early corporation did not exist without a special grant of authority from the monarch. *Id.* In mediaeval Europe, churches and local governments became incorporated in order to exist beyond the life or lives of particular persons, e.g., the local magistrate, bishop, mayor, etc. *Id.* at 46-47. Stewart Kyd, the first author of a treatise on corporate law in England, defined a corporation as:

a collection of many individuals, united into one body, under a special denomination, having perpetual [s]uccession under an artificial form, and [v]ested, by the policy of the law, with the capacity of acting, in several [r]espects, as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution, or the powers conferred upon it, either at the time of its creation, or at any subsequent period of its existence.

Id. at 13.

³The classification of tax entities is typically determined under the "check-the-box" treasury regulations. Treas. Reg. §§ 301.7701-2, -3 (2008). According to the "check-the-box" regulations, an "eligible entity" is a business organization recognized for federal tax purposes that is not treated as a trust and is not required to be treated as a corporation for tax purposes. *Id.* § 301.7701-2. Eligible entities may be classified as a disregarded entity if it has one owner, as a tax partnership if it has more than one owner, or, regardless of the number of owners, as a tax corporation if it so elects. *Id.* §§ 301.7701-2, -3. The "election" is made on Form 8832. *Id.* at 301.7701(c)(1)(i).

⁴DEL. CODE ANN. tit. 6, § 18-1101(b) (2005) (stating that the "policy of this chapter is to give maximum effect to the principle of freedom of contract"); *id.* § 17-1101(c) (same).

⁵*Id.* § 18-301(d) (describing the requirements for admission of members in a Delaware LLC).

⁶*Id.* § 18-302(a) (describing classes and voting rights in a Delaware LLC).

⁷As noted in the Blackstone Group, LP prospectus:

We are a limited partnership and as a result will qualify for and intend to rely on exceptions from certain corporate governance and other requirements under the rules of the New York Stock Exchange . . . Pursuant to these exceptions, limited

Delaware adopted a series of amendments to its alternative entity acts that authorize owners to contractually limit or eliminate *duties and liabilities*, including fiduciary duties of owners or managers to each other, the entity, or another person that is a party to the entity's private agreement, so long as no attempt is made to limit or restrict the implied contractual covenant of good faith and fair dealing.⁸

The result of Delaware's *duties and liabilities* amendments is that public LLCs and LPs have the ability to protect owners and managers against *liability* for certain breaches of fiduciary duties if the parties desire. In addition, if particular fiduciary duties are eliminated, advisors to the owners and managers (such as attorneys, bankers, accountants, and appraisers) may serve the organization without concern for: (1) aiding and abetting managers, managing members, or general partners in a breach of an exculpated duty; or (2) breach of fiduciary duty under the rules of professional responsibility for aiding and abetting a managing client's breach of fiduciary duty. Under the current corporate scheme of the Delaware General Corporation Law (DGCL), no such protection for advisors to a board of directors is available since section 102(b)(7) only permits the elimination of personal accountability of a director to the corporation or its stockholders for monetary liability for the fiduciary duty of care.⁹

Another incentive for greater contractual flexibility in modifying or redefining fiduciary duties in Delaware corporations is the advent of the Beneficial Corporation (B Corporation).¹⁰ A B Corporation is a "purpose-driven"

partnerships may elect not to comply with certain corporate governance requirements of the New York Stock Exchange, including the requirements (1) that a majority of the board of directors of our general partner consist of independent directors, (2) that we have a nominating/corporate governance committee that is composed entirely of independent directors In addition, we will not be required to hold annual meetings of our common unitholders. Following this offering, we intend to avail ourselves of these exceptions. Accordingly, you will not have the same protections afforded to equityholders of entities that are subject to all of the corporate governance requirements of the New York Stock Exchange.

Blackstone Group, L.P., Prospectus (Form 424(b)(4)), at 55 (2007).

⁸See, e.g., DEL. CODE ANN. tit. 6, § 18-1101(c) (2005) (permitting the elimination of fiduciary duties in LLCs); *id.* § 17-1101(d) (permitting the elimination of fiduciary duties in LPs); *id.* § 15-103(f) (permitting the elimination of fiduciary duties in general partnerships); DEL. CODE ANN. tit. 12, § 3806(c) (2007) (permitting the elimination of fiduciary duties in statutory trusts).

⁹DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

¹⁰The "B" stands for "beneficial" in the sense that the corporation's purpose is to be beneficial to the business, the public, and to the environment. In this manner, the B Corporation does not exist solely for its stockholders or even the stakeholders of the 1980's and 1990's takeover era. The B Corporation extends its "benefit" by creating a "purpose-driven" business entity that gives back to the community and the environment. See Sarah Kuck, "B" is for Beneficial: The B Corporation, WORLDCHANGING, May 22, 2008, <http://www.worldchanging.com/archives/008059.html>.

The Delaware Division of Corporations has, in communications with the author during September 2008, stated that it would accept a filing that included nonstockholder or "stakeholder" constituents but would not append a "B" designation to the corporate filing. Of course, the fact that the Delaware Secretary of State accepts such a filing makes no statement as to its legal effect.

Another new "kid" on the entity block is the L3C. The L3C (a low-profit limited liability company) is a "program-related investment" device where the primary purpose is to achieve a charitable purpose and "no significant purpose of the investment is the production of income or the appreciation of property." Treas. Reg. § 53.4944-3 (2008). A program-related investment must meet three requirements:

- (i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B);
- (ii) No significant purpose of the investment is the production of income or the appreciation of property; and
- (iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

Id.

Vermont has announced an amendment to its LLC Act to provide for the L3C. *See* VT. STAT. ANN. tit. 11, § 3001(27) (2008) that provides:

(27) "L3C" or "low-profit limited liability company" means a person organized under this chapter that is organized for a business purpose that satisfies and is at all times operated to satisfy each of the following requirements:

(A) The company:

(i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(B); and

(ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.

(B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

(C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(D).

(D) If a company that met the definition of this subdivision (27) at its formation at any time ceases to satisfy any of the requirements, it shall immediately cease to be a low-profit limited liability company, but by continuing to meet all the other requirements of this chapter, will continue to exist as a limited liability company.

Id. The name of an L3C must contain the abbreviation L3C or l3c. *Id.* § 3005(a)(2). This Act was signed by the governor of Vermont on April 30, 2008.

In addition to Vermont, similar legislation has been considered in Georgia, Michigan, Montana, North Carolina, and South Carolina. The L3C is considered a hybrid between a for-profit and not-for-profit organization. It is for-profit in the sense that it has equity owners that are entitled to receive distributions and any appreciation in the value of their investment. It is like a nonprofit entity, however, in the sense it is organized essentially for social or charitable purposes. *See* Thomas H. Moody, *The Promise of the L3C*, TRUSTS & ESTATES, Sept. 2008, at 16, 16-18.

In 2007, Hawaii introduced a Senate Bill for the enactment of an "Ingenuity Corporation." The Hawaii ingenuity corporation is to be a "private, for profit, non-stock, membership corporation" that is intellectually and environmentally driven to:

business that creates benefits for an array of stakeholders, e.g., stockholders, the business, creditors, employees, consumers, the community in which the corporation operates, and the environment.¹¹ The B Corporation is a certification¹² that a company is socially and environmentally responsible, as well as seeking a financial return—the "triple bottom line."¹³ Well-known B

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- (1) Hold and use intellectual and other property;
 - (2) Create benefits for inventors nationally, labor unions nationally, and public education in Hawaii to promote the teaching of innovation and its application for the common good;
 - (3) Create and maintain businesses operating with International Labor Organization work standards and United Nations environmental standards, providing innovation education, employment opportunities, and economic development for Hawaii;
 - (4) Raise global labor and environmental standards and build Hawaii's role as an inventor-friendly state;
 - (5) Engage in any lawful business that operates with International Labor organization labor standards and United Nations environmental standards and sell, lease, or license goods and services only to business entities meeting International Labor Organization labor standards and United Nations environmental standards;
 - (6) Enable inventors, labor unions, the American Ingenuity Alliance, and public educators to create a business entity that owns and licenses intellectual and other property;
 - (7) Attract inventors to Hawaii;
 - (8) Negotiate with other corporations on behalf of all the constituency groups on issues of licensing intellectual property, labor, and environmental standards; and
 - (9) Permit the corporation to collectively bargain and declare that exercising such power on behalf of inventors and labor organizations is an exception to all state anti-trust and anti-competitive practice rules.

S.B. 773, 24th Leg., § (1)(3) (Haw. 2007), *available at* http://www.capitol.hawaii.gov/session/2008/bills/SB773_SD1_.htm.

Under the bill, the board of directors of an ingenuity corporation must "[o]perate the corporation to fulfill the purposes of this charter and *serve as fiduciaries in the best interests of all the members.*" *Id.* § 1(13)(6) (describing the duties of the board) (emphasis added). The Act is to take effect July 1, 2050. *Id.* § 2.

¹¹See *infra* note 16 for a discussion of constituency statutes and their sources.

¹²Kuck, *supra* note 10 (stating that to become a B Corporation applicants must score a certain number on a certification test). B Lab, a Berwyn, Pennsylvania-based nonprofit business, was formed two years ago to provide a method for certifying the authenticity of "socially responsible businesses," along the same lines as the nationally known firm, Leadership in Energy and Environmental Design, a system for green buildings. B Lab rates a prospective company on five factors—community, consumers, employees, environment, and leadership. *Id.* B Lab also considers information such as the percentage of employee ownership and the number of shareholders on the board of directors. To be "certified" as a B Corporation, an applicant must score forty out of one hundred points and then must amend the company's certificate of incorporation to include the nonshareholder stakeholders upon which the company was certified. *Id.* See also Anne Field, *Do-Good Investing*, TRUSTS & ESTATES, Feb. 27, 2008, http://trustsandestates.com/wealth_watch/Wealth_Watch_News_02272008/ (discussing B Labs).

¹³Field, *supra* note 12. It is said that:

Corporations include Burt's Bees; Ben and Jerry's; Dansko; Abacus Wealth Partners, LLC; Fair Trade Sports; BetterWorld Telecom; Untours; and Numi Tea.¹⁴ The ambiguities that the B Corporation presents in modern corporate law are not insignificant: (1) Does the inclusion of "B" stakeholders in a certificate of incorporation create only *contractual duties* of directors to stakeholders and *fiduciary duties* to the entity's stockholders?¹⁵ (2) May shareholders amend a corporate charter to extend rights and duties to nonstockholders in the absence of a freedom of contract or other statutory provision in the applicable corporate law?¹⁶ (3) May the business judgment

Hardwiring [a B corporation] both for-profit and for-purpose through the B Corporation's founding document gives legitimacy to the simultaneous pursuit of goals that are usually defined as being contradictory. Instead of these goals competing with each other, and instead of one goal being sacrificed for the other, the for-purpose and for-profit goals must both be pursued.

CV Harquail, *B Corporation Identity: An Opportunity for Organizational Authenticity*, AUTHENTIC ORGS., May 1, 2008, <http://authenticorganizations.com/harquail/2008/05/01/b-corporation-identity-an-opportunity-for-organizational-authenticity/> (emphasis omitted). By being an "authentic" B Corporation, management "must use their judgment to balance any competing demands or potential contradictions." *Id.* Studies indicate that the "balancing act," though difficult, is "legitimate." *Id.* In addition, by existing as an authentic B Corporation, "it is less vulnerable to the whims and preferences of the individuals running the corporation at any given time. And, the social purpose cannot be tossed overboard in a sinking market." *Id.*

¹⁴All of the B organizations listed are not only committed to social and environmental responsibility, but many are also engaged in funding philanthropic and other beneficial projects. One such B company, eConscious Market, is the Internet's largest eco-marketplace by donating fifty percent of its net profits to nonprofit organizations that its customers choose while shopping on the Internet. See B Corporation.net, <http://www.bcorporation.net/community> (last visited July 28, 2008).

¹⁵DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). The theory here is that the certificate of incorporation is a "contract" between the corporation, state, and its stockholders, as well as between the corporation and its stockholders, "inter sese." See *Morris v. Am. Pub. Utils. Co.*, 122 A. 696, 700 (Del. Ch. 1923). The board of directors is invested with original authority to manage the business and affairs of the corporation according to the contract. DEL. CODE ANN. tit. 8, § 141(a) (2001). In a jurisdiction such as Delaware, the directors also must manage the corporation according to the common law fiduciary duties of care and loyalty. *Stone v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006) (holding that the obligation to act in good faith is not an independent fiduciary duty but is "a subsidiary element" of the duty of loyalty). See generally *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693 (Del. Ch. 2005). Therefore, a contractual expansion of "stakeholders" in a certificate of incorporation would reasonably create *contractual* obligations to all stakeholders but would not unilaterally extend *fiduciary* duties or standing to employees, consumers, suppliers, members of the community, or persons acting in a representative capacity for the "environment" in the absence of a "B" statute creating such rights and obligations.

¹⁶See DEL. CODE ANN. tit. 8, § 102(b)(1) (2001):

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:

(1) Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the members of a nonstock corporation; if such

rule serve as a shield for all directorial decisionmaking (or directorial decisions) in a B Corporation¹⁷ or only those that affect purchasers of equity in

provisions are not contrary to the laws of this State. Any provision which is required or permitted by any section of this chapter to be stated in the bylaws may instead be stated in the certificate of incorporation.

Id.

Another issue is whether a B Corporation may be formed in the face of an existing "constituency statute" that provides, for example, that directors may consider "other constituencies" in the event of a threatened change of control. In this circumstance, a state has arguably already addressed the issue of "other constituencies" and limited the consideration of stakeholders to a corporate acquisition or hostile takeover. In the absence of a subsequent enactment of a B Corporation statute, can a "B amendment" to a certificate of incorporation broaden the scope of an existing constituency statute?

Several jurisdictions have constituency statutes. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1202(A) (2004); CONN. GEN. STAT. § 33-756 (2005); FLA. STAT. § 607.0830(3) (2007); HAW. REV. STAT. § 414-221 (2008); IDAHO CODE ANN. § 30-1-602 (2005); 805 ILL. COMP. STAT. 5/8.85 (2004); IND. CODE § 23-1-35-1 (1999); IOWA CODE § 490.1108 (1999); KY. REV. STAT. ANN. § 271B.12-210(4) (LexisNexis 2006); LA. REV. STAT. ANN. § 12:92(G) (1994); ME. REV. STAT. ANN. tit. 13-C, § 831 (2005); MASS. GEN. LAWS ch. 156B, § 65 (2005); MINN. STAT. § 302A.251 (2004); MISS. CODE ANN. § 79-4-8.30(d) (1999); MO. REV. STAT. § 351.347 (2001); NEB. REV. STAT. § 21-2045(1) (2008); N.J. REV. STAT. § 14A:6-1 (2003); N.M. STAT. § 53-11-35(D) (2001); N.Y. BUS. CORP. LAW § 717(b) (Consol. 2003); OHIO REV. CODE ANN. § 1701.59(E) (LexisNexis 2004); OR. REV. STAT. § 60.357(5) (2007); 15 PA. CONS. STAT. § 1715-16 (1995); R.I. GEN. LAWS § 7-5.2-8(a) (1999); S.D. CODIFIED LAWS § 47-33-4 (2007); TENN. CODE ANN. § 48-18-301 (2002); WIS. STAT. § 180.0827 (2002); WYO. STAT. ANN. § 17-16-830 (2007).

Typically the constituency acts exist as amendments to statutory statements of a director's duty of care. In most cases, the acts provide that in fulfilling managerial duties of care, directors may consider employees, creditors, suppliers, consumers, and the community at large, but not the environment. Two further points must be noted about constituency acts: (1) most do not operate solely within the context of takeovers (only Connecticut, Iowa, Louisiana, Missouri, Oregon, Rhode Island, and Tennessee limit their constituency statutes' effect to corporate acquisitions); see CONN. GEN. STAT. § 33-313(e) (2002); IOWA CODE § 490.1108 (2008); LA. REV. STAT. ANN. § 12:92(G) (1994); MO. REV. STAT. § 351.347 (2001); OR. REV. STAT. § 60.357(5) (2007); R.I. GEN. LAWS § 7-5.2-8(a) (1999); TENN. CODE ANN. § 48-35-204 (2002); and (2) only Connecticut *requires* the consideration of stakeholder interests—all other constituency statutes are permissive only. *See* CONN. GEN. STAT. § 33-313(e) (2002). In light of the permissive nature of these acts, it is difficult to imagine that their existence in any given jurisdiction would broaden directorial duties beyond those traditionally owed to stockholders.

¹⁷When a stockholder brings a derivative suit alleging a breach of fiduciary duty by directors, the business judgment rule protects the directors' decision by presuming that the decision is proper and was made in good faith. *See, e.g.*, *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 n.10 (Del. 1981); *Maldonado v. Flynn*, 413 A.2d 1251, 1255 (Del. Ch. 1980), *rev'd on other grounds*, 430 A.2d 779 (Del. 1981). In addition, in order for the business judgment rule to attach, Delaware requires that the board be informed before reaching its decision. *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). The Delaware Supreme Court has noted a distinction between the business judgment rule, which shields corporate management from personal liability with respect to business decisions, and the business judgment doctrine, which protects the decision itself from review. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 n.10 (Del. 1986).

The only circumstance where corporate law permits a derivative suit by a nonstockholder is that of a creditor where a corporation is insolvent. *See* N. Am. Catholic Educ. Programming

the corporation? and (4) Is it likely that institutional investors in a public corporation would gain sufficient voting support to amend the certificate of incorporation in order to pursue a B certification?¹⁸ Certainly, without the contractual flexibility to modify or retool the parameters of directorial duties or to address the application of informed business judgments to nonstockholders, directors facing the social and environmental directives of a B Corporation are exposed to the uncertainties of personal liability.

II. BACKGROUND

Delaware adopted the modern version of the DGCL over one hundred years ago.¹⁹ After the DGCL's enactment in 1899 and subsequent revisions in

Found., Inc. v. Gheewalla, 930 A.2d 92, 94 (Del. 2007) (holding that individual "creditors of a Delaware corporation that is either insolvent or in the zone of insolvency have no right, as a matter of law, to assert direct claims for a breach of fiduciary duty against the corporation's directors"). A derivative suit may only be brought, in the absence of facts of self-dealing or disloyalty by directors, where a corporation is insolvent and is subject to a section 102(b)(7) exculpation clause in a certificate of incorporation. See Ann E. Conaway, *Trenwalla: A Call for Rationalizing Fiduciary Duties to Creditors in Delaware* (Widener Law Sch. Stud., Working Paper No. 08-09, 2007), available at <http://ssrn.com/abstract=991224>.

Therefore, if a B Corporation is formed with nonstockholder constituencies and the certificate of incorporation provides that "the corporation is to operate for the benefit of X according to the business judgment of the directors," would the common law business judgment rule protect directorial decisions as to nonstockholder constituencies? Would the same result occur if the certificate of incorporation made no reference to "the business judgment of the directors"?

¹⁸At the end of May 2008 in Dallas, Texas, the Rockefeller family led a large United States and international institutional investor group in an attempt to make changes to Exxon Mobile. Among the changes were (1) the independence of the CEO from the chairman of the board, (2) a study of the impact of gas emissions on the community, (3) research on environmentally friendly courses of action for the company, (4) general research on sustainability issues of other countries, and (5) a "say on pay" of the executives of the company. After several prior attempts to pass these same items, which had gained up to 40% in favorable votes, the 2008 vote was defeated by a 39.5% vote. What this realistically represents is that once directors are elected, attempts at shareholder activism through the voting franchise in a public corporation will inevitably fail unless the directors also back the proposal. See, e.g., Steven Mufson, *Rebutting the Rockefellers*, WASH. POST, May 29, 2008, at D1.

However, the "business" of climate change is underway around the world. The British government in 2006 commissioned a report by Sir Nicholas Stern on the effect of unabated global warming and climate change. Tony Blair, *Lead the Way on Climate Change*, NEWS J., June 5, 2008, at A11. Sir Nicholas Stern's report concluded that "it is far riskier economically to ignore climate change than to act to abate it." *Id.* As a result, Europe introduced the Emissions Trading System where nearly half of all emissions are now tradable. *Id.* Japan, China, and India have all instituted national climate action plans. Israel is considering tax incentives for electric powered cars. *Id.* The bottom line is that many countries outside the United States, as well as some U.S. states, are discovering that reducing gas emissions can increase productivity and provide a competitive advantage for their business. In a sense, for example, the Rockefeller family was simply seeking the "triple bottom line" for Exxon Mobile—financial reward, social responsibility, and environmental stewardship.

¹⁹Delaware's first constitution was enacted in 1776. S. Samuel Arshat, *A History of*

1967, 1973, and 1974, Delaware became widely known as the state of

Delaware Corporation Law, 1 DEL. J. CORP. L. 1, 2 (1976). In the original Delaware Constitution, there was no reference to corporations, however, the constitution adopted that the common and statutory law of England, then in effect, would remain in effect. *Id.* Incorporation during this period required a special act of the legislature and only three incorporations took place in Delaware during this time. *Id.* In 1786, "the first special incorporation act . . . granted a charter to the Bank of North America." *Id.* The legislature granted a second special charter to the Wilmington Library Company in 1788. *Id.* at 2 n.9. The third special act of incorporation was granted to the physicians of the State of Delaware in 1789. *Id.*

The Delaware Constitution was amended in 1792 and provided "that the rights, privileges, immunities and estates of corporate bodies shall remain as if the constitution of this state had not been altered." *Id.* (quoting DEL. CONST. of 1792, art. VIII, § 9 (amended 1831)). Despite the amendment, incorporations still required special acts by the legislature. *Id.* Notwithstanding the special grant limitation, Delaware began to see an increase of incorporations, in part, because Delaware recognized the doctrine of limited liability for a corporation. For example, between 1800 and 1810, "twelve incorporations, excluding those of municipalities and educational and religious groups, took place." *Id.* at 2-3. Between 1820 and 1831, eighteen business incorporations were granted. *Id.* at 3.

The Delaware Constitution of 1831, for the first time, "impose[d] substantive restrictions upon the legislature's powers of incorporation." *Id.* The Delaware Constitution of 1831 provided: "No act of incorporation, except for the renewal of existing corporations, shall be hereafter enacted without the concurrence of two-thirds of each branch of the Legislature . . . for a longer period than twenty years, without the re-enactment of the Legislature, unless it be an incorporation for public improvement." *Id.* (quoting DEL. CONST. art. II, § 17 (1831)). The revocation provisions were added in response to the United States Supreme Court's ruling in *Trustees of Dartmouth College v. Woodward*, which "held that a corporate charter was a contract between the state and the corporation and that it could not be changed unilaterally by the state because Article I, Section 10 of the United States Constitution" provides that states may not impair the obligation of contracts. *Id.* (citing *Trustees of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819)). The limitation of twenty years on the duration of the corporation was adopted in response to the increasing number of private, rather than public, corporate ventures. *Id.*

Finally, 1875, the Delaware Constitution was amended to permit the legislature "to enact a general incorporation act to provide incorporation for religious, charitable, literary and manufacturing purposes, for the preservation of animal and vegetable food, building and loan associations, and for draining low lands." *Id.* at 4 (quoting 15 Del. Laws 3 (1875)). The first general incorporation law adopted pursuant to the constitution of 1875 remained in effect until 1883. *Id.* Under this constitution, a corporation could be created by a special grant or formed by the general corporation law. *Id.* The general corporation law at that time was complex and confusing so most sponsors formed according to special grants and ignored the new general corporation act. *See id.* at 5. Thus, by 1897, 115 special acts of incorporation, or related charters, were granted, in contrast to the ten that occurred under the general law of 1833. *Id.*

The profligation of special acts also increased the efforts of lobbyists and the cries of corruption. *Id.* To remedy these difficulties, the constitution of 1897 eliminated special acts of incorporation, removed the twenty-year restriction on duration, and eliminated the restrictions on purposes. *Id.* at 6. As is common lore in Delaware, these provisions were largely patterned after the general incorporation laws of New Jersey. *See id.* For a general discussion of New Jersey's original position as the founder of modern corporate law, see, e.g., Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 265-70 (1976). For another interesting work on the history of Delaware and New Jersey, see William E. Kirk, III, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-eminence*, 10 J. CORP. L. 233 (1985).

incorporation and for its incorporation phenomenon.²⁰ Today, Delaware boasts the residence of over sixty-three percent of the Fortune 500 companies.²¹ Delaware's success is not simply its organic law that is revised for modernization, when a need for revision is perceived, but also comes from the national acclaim and trust with which investors view the Delaware Court of Chancery and the Delaware Supreme Court. In addition, businesses consider the Delaware Secretary of State's office to be efficient and business friendly.²² Finally, the Delaware corporate bar enjoys an outstanding national reputation for its corporate experts and litigation specialists. This package of attributes serves to distinguish Delaware and firmly establish it as the "state of incorporation."

During a small segment of the "reign of the Delaware corporation," Delaware offered other forms of businesses such as limited partnerships and general partnerships.²³ Unlike the nineteenth century origin of the DGCL, however, Delaware did not adopt its Limited Partnership Act until 1983.²⁴

²⁰See, e.g., William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 668-701 (1974) (stating that Delaware was "a pygmy among the [fifty] states [that] prescribes, interprets, and indeed denigrates national corporate policy as an incentive to encourage incorporation within its borders, thereby increasing its revenue"). Professor Cary, of course, advocated for the imposition of minimum federal standards that would have applied only to public corporations. *Id.* at 701-02. Professor Cary's arguments were rejected rather soundly and no longer gain much academic notice, except from an historical perspective. See generally Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982) (criticizing the "race to the bottom" thesis); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003) (arguing that federal intervention rather than competition from other states is the principal threat to Delaware); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (asserting that state competition is a race to the top benefiting shareholders).

²¹In the 2007 Annual Report for Delaware, Secretary of State Harriet Smith Windsor reports that Delaware presently is the residence for sixty-one percent of the Fortune 500 companies. See HARRIET SMITH WINDSOR, DEL. DEP'T OF STATE: DIV. OF CORPS. 1 (2007), available at <http://corp.delaware.gov/2007DivCorpAR.pdf>. As of May 31, 2008, that number increased to over sixty-three percent. The information for statistics after the 2007 Annual Report was obtained from Delaware's Office of the Assistant Secretary of State.

²²In addition to the links for electronic filings, sample forms, recent legislation, and text of Delaware entity laws on the Delaware Secretary of State's website, the Delaware Court of Chancery and the Delaware Supreme Court have made opinions, docket information, and pleadings for civil actions available over the Internet. See, e.g., Delaware State Courts, <http://courts.delaware.gov/opinions> (follow "opinions" hyperlink).

²³Delaware adopted its Revised Uniform Partnership Act, effective June 1, 2001. See DEL. CODE ANN. tit. 6, §§ 15-101 to -1210 (2005). This Act was based upon the National Conference of Commissioners on Uniform State Laws (NCCUSL) Revised Uniform Partnership Act of 1997.

²⁴DEL. CODE ANN. tit. 6, §§ 17-101 to -1111 (2005).

Delaware's Statutory Trusts Act (DSTA)²⁵ was not adopted until 1988 and Delaware's Limited Liability Company Act (DLLCA) was enacted in 1992.²⁶ Prior to the adoption of LLCs, Delaware's Revised Uniform Limited Partnership Act (DRULPA)²⁷ underwent substantial revisions, the most important of which was the addition in 1990 of the statutory policy of giving "maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."²⁸ In addition, the 1990 amendments permitted each Delaware alternative entity to:

- (1) expand or restrict duties (including fiduciary duties) owed by a person or partner to each other or to the entity, provided that the private organic agreement did "not eliminate the implied contractual covenant of good faith and fair dealing";²⁹

²⁵The DSTA was formerly known as the Delaware Business Trusts Act. The amendment to statutory trusts was made in 2002 for the purpose of avoiding any implication that a trust formed under title 12 of the Delaware Code is a "business trust" within the meaning of title 11 of the United States Code. See 73 Del. Laws 328 (2002).

²⁶The first LLC was adopted in Wyoming in 1977. See Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998). The Wyoming LLC was the result of an oil and gas venture in Brazil that was operating as a Brazilian "limitadas" which permitted partnership-like flexibility and corporate limited liability. *Id.* at 1463-64. The "limitadas" was first offered to the Alaska legislature as a new form of business. *Id.* at 1464. Because Alaska refused the opportunity, Wyoming became the first state to create the hybrid entity that is today known as the LLC. *Id.* at 1465. From the time of its adoption in 1977 up to today, the Wyoming LLC requires at least two members for formation. See WYO. STAT. ANN. § 17-15-106 (2007).

The next state to act on LLC legislation was Florida in 1982. Hamill, *supra*, at 1469. These early acts operated in great uncertainty regarding the taxation of the new entity. *Id.* at 1468-69. In 1988, however, with IRS Revenue Ruling 88-76, the IRS created greater clarity by providing for the characterization of the LLC as a partnership so long as it did not have continuity of life and transferability of ownership interests. *Id.* at 1469-70. Thereafter, in 1990, Colorado and Kansas adopted LLC Acts. *Id.* at 1470. Four jurisdictions adopted new LLC Acts in 1991: Nevada, Texas (also allowing a single member), Utah, and Virginia. *Id.* Delaware enacted the DLLCA in 1992. *Id.* at 1475. In 1994, jurisdictions began to reduce the required number of members from two (partnership model) to one (corporate model). In 1996, the IRS implemented the "check-the-box" tax classification system for unincorporated entities whereby investors could choose their tax classification. *Id.* at 1483. Thus, eleven years after its inception in Wyoming, the LLC finally received favorable tax recognition from the IRS in Revenue Ruling 88-76 and general freedom of choice at twenty years. *Id.* at 1477-78.

²⁷DEL. CODE ANN. tit. 6, §§ 17-101 to -1111 (2005). Delaware's Limited Partnership Act was adopted in 1983 as a nonuniform version of the NCCUSL Revised Uniform Limited Partnership Act.

²⁸*Id.* § 17-1101(c).

²⁹*Id.* § 18-1101(c); *id.* § 17-1101(d); *id.* § 15-103(a)-(b); DEL. CODE ANN. tit. 12, § 3806(c) (2007).

- (2) limit or eliminate the liability of a partner or other person to each other or to the entity for breach of contract or breach of fiduciary duty, provided that no exculpation could be granted in a private organic document for any act or omission that constituted "a bad faith violation of the implied contractual covenant of good faith and fair dealing";³⁰ and
- (3) exculpate a partner or other person that is a party to the entity's private organic document or is otherwise bound by that agreement for breach of fiduciary duty, where such person relies in good faith upon the terms of the private organic document.³¹

In 2004, the General Assembly amended the language "expand or restrict," when used to describe the contractual parameters of *duties*, to make clear that "restrict" included "eliminate."³² Many found the 2004 amendment somewhat surprising; in fact, the Delaware statute allowed the complete elimination of fiduciary duties and liabilities in the context of trusts since 1983.³³

This statutory espousal of a contractual,³⁴ rather than a fiduciary, theory of alternative entity law liberated Delaware LP investors from the regulatory, and somewhat paternalistic, rules of corporate law. Instead, investors in Delaware limited partnerships and, two years later, limited liability companies and statutory trusts, found themselves unfettered by infrastructure convention, benefiting from the opportunity to avoid entity taxation and the ability to cast their bargains according to their sophistication, financial acumen, market niches, and length of desire in the venture.

After the appearance of the hybrid, contractually based Delaware LLC investors achieved utmost bargain efficiency, limited liability, and favorable tax treatment—if the entity did not have continuity of life and transferability of

³⁰DEL. CODE ANN. tit. 6, § 18-1101(e) (2005); *id.* § 17-1101(f); *id.* § 15-103(f); DEL. CODE ANN. tit. 12, § 3806(e) (2007).

³¹DEL. CODE ANN. tit. 6, § 18-1101(d) (2005); *id.* § 17-1101(e); *id.* § 15-103(e); DEL. CODE ANN. tit. 12, § 3806(d) (2007).

³²See *supra* note 8 for Delaware alternative entity statutes permitting the elimination of fiduciary duties and liabilities in partnership, operating, and trust agreements.

³³68 Del. Laws 434 (1983).

³⁴DEL. CODE ANN. tit. 6, § 17-1101(c) (2005) ("It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.").

ownership interests.³⁵ The Delaware LP, however, can be organized with a shielded general partner,³⁶ limited liability to its limited partners, and be classified as a partnership for tax purposes. The stated policy of "freedom of contract," however, was the critical legal recognition that forever placed in sponsors the ability to craft their private organic agreements unfettered by a rules-based regime, including experimentation with management roles, voting rights, and economic rights of investors.

Thus, the success of the Delaware entity "formation phenomenon" is due to a multiplicity of factors: (1) advanced and flexible corporate and alternative entity laws; (2) the sophistication of the Delaware Court of Chancery and its reviewing court, the Delaware Supreme Court, that together have penned the most significant corporate and unincorporated case law in modern history; (3) an accessible and efficient Secretary of State's Office; and (4) a general perspective that Delaware is a sophisticated and fair forum for businesses.³⁷ Delaware's continued success is reflected in the 2007 Annual Report of the State of Delaware, Department of State, Division of Corporations. In that report, Delaware Secretary of State, Harriet Smith Windsor, reports that Delaware, as of December 31, 2007, is the resident of 846,000 domestic entities.³⁸ Of that number, 553,349 were domestic Delaware alternative entities, including LPs,³⁹ statutory trusts,⁴⁰ LLPs,⁴¹ and LLCs.⁴² Delaware corporations accounted for 293,148 of the over 846,000 domestic entities. The most remarkable figure is that since only 1992, Delaware has

³⁵See, e.g., Rev. Rul. 88-76, 1988-2 C.B. 360. For the first time, there was greater clarity from the IRS in the tax classification of the LLC and, as a result, more states began to adopt LLC acts between 1990 and 1992.

³⁶A limited partnership is defined as a "partnership" formed with one or more general partners and one or more limited partners. See DEL. CODE ANN. tit. 6, § 17-101(a) (2005). Just as in general partnership law, the general partner in a limited partnership is vested with control and management rights as well as liability. *Id.* § 17-403. In large transactions, common practice includes organizing the general partner as a corporation in order to minimize individual personal liability of the general partner. Today, many limited partnerships are organized with LLCs as the general partners. The LLC achieves the same limitation on individual personal liability that the corporation offers, yet the LLC also grants limitless structural flexibility and favorable tax treatment.

³⁷See WINDSOR, *supra* note 21, at 1 (stating that "Delaware is . . . a unique and favored gateway to the U.S. marketplace").

³⁸*Id.*

³⁹As of the year-end 2007, Delaware was the resident of 68,133 LPs. This information was provided by the Division of Corporations. See *id.*

⁴⁰Delaware's statutory trusts for the same period totaled 20,821. *Id.*

⁴¹Delaware is home to 376 LLPs. See WINDSOR, *supra* note 21, at 1.

⁴²As of 2007, Delaware was the resident of 464,019 LLCs. *Id.*

formed 464,019 limited liability companies, out of a total of 846,497 domestic entities.⁴³

In terms of revenue, Secretary of State Windsor reports that general fund revenue collections increased thirty-three percent since 2000 to a new record of \$701 million in fiscal year 2007.⁴⁴ That "[r]evenue growth was broad-based, led by [twenty] percent growth in tax collections from limited liability companies and limited partnerships."⁴⁵ Corporate "revenue accounted for twenty-two percent of the State's general fund in fiscal year 2007."⁴⁶ The UCC-1 filings, active in Delaware for the 2007 fiscal year, were over 645,000, "a 539 percent increase since Revised Article IX took effect in July 2001."⁴⁷ In fiscal year 2007, UCC general fund revenues exceeded \$13 million dollars.⁴⁸

It is clear from these statistics that Delaware continues its prominence in entity formation. These figures also indicate that an evolution has occurred in Delaware—a remarkable shift from corporate filings to LLC formations. Delaware, however, retains its impressive stature as the choice of jurisdiction for Fortune 500 companies.⁴⁹ What the reported data does not reveal is that Delaware is presently the residence of almost 100 publicly traded alternative entities.⁵⁰ Is this choice of public entity reversal an aberration or is the marketplace beaconing change? And if the dawn of public alternative entities is authentic, how may Delaware unincorporated entity laws inform the next generation of the DGCL?

⁴³As of May 31, 2008, the number of LLCs in Delaware increased to approximately 490,000. Statistic obtained from the Delaware Secretary of State.

⁴⁴WINDSOR, *supra* note 21, at 1.

⁴⁵*Id.*

⁴⁶*Id.* at 2.

⁴⁷*Id.* The revisions to UCC Article IX allow creditors to file security interests where an entity is formed, organized, or incorporated rather than the prior rule that focus on the locus of the collateral. *Id.*

⁴⁸WINDSOR, *supra* note 21, at 2.

⁴⁹*Id.* at 1.

⁵⁰This information was obtained from a telephone call with the Office of the Assistant Secretary of State.

III. DISCUSSION

A. *The Corporate Contract—Contract Theory and the Corporation*

For decades, legal scholars have debated the appropriate impact of law and economics principles in the area of corporate law.⁵¹ In its purist form, a law and economics theory advances private ordering, to the point of eliminating all regulation and allowing the free pursuit of economic efficiency. The quest for economic efficiency allows the pressures of the marketplace to punish the improper or "bad" conduct by corporate managers.⁵² To these "contractarians," shareholders should be free to eliminate all of the mandatory fiduciary duties of managers through free bargaining between corporate managers (directors and officers) and the corporation (or the corporation's

⁵¹See, e.g., ADOLF A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* 25-60 (1955); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1998); NIGEL KENDALL & ARTHUR KENDALL, *REAL-WORLD CORPORATE GOVERNANCE: A PROGRAMME FOR PROFIT-ENHANCING STEWARDSHIP* (1998); A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 125-33 (3d ed. 2003); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (7th ed. 2007); RICHARD A. POSNER & KENNETH E. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION* (1980); ROBERTA ROMANO, *FOUNDATIONS OF CORPORATE LAW* (1993); Henry N. Butler, *The Contractual Theory of the Corporation*, 11 *GEO. MASON L. REV.* 99 (1989); R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 163 (Margaret M. Blair & Mark J. Roe eds., 1999); Peta Spender & Stephen Bottomley, *How to Do Things with Contractarianism: Michael Whincop's Contribution to Corporate Law Scholarship*, 13 *GRIFFITH L. REV.* 9, 11-15 (2004).

In the early 1930s, a series of three articles published by Professor A.A. Berle, Jr. and Professor E. Merrick Dodd, Jr. set out the two models for a modern corporation. Professor Berle stated, "[A]ll powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears." A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 *HARV. L. REV.* 1049, 1049 (1931). Professor Dodd argued that directors should exercise their fiduciary powers, not only for shareholders, but also for employees, creditors, and consumers, such that "the business corporation [is] an economic institution which has a social service as well as a profit-making function." E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 *HARV. L. REV.* 1145, 1148 (1932). Professor Berle defended his stockholder-driven model of private ordering that would exclude consideration of employees in A.A. Berle, Jr., *For Whom Corporate Managers are Trustees: A Note*, 45 *HARV. L. REV.* 1365 (1932).

⁵²E.g., JEREMY BENTHAM, *AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION* (J.H. Burns & H.L.A. Hart eds., 1996); JOHN STUART MILL, *UTILITARIANISM* (Oskar Pietsch ed., 1957) (founding works on utilitarianism—contractarians defend the pursuit of economic efficiency on the theory that it will lead to maximum utility). For a more recent discussion of utilitarianism, see J.J.C. SMART & BERNARD WILLIAMS, *UTILITARIANISM: FOR AND AGAINST* (1973).

shareholders) since only this process results in true economic efficiency.⁵³ The contractarian position views a mandatory imposition of fiduciary duties on corporate managers as being incompatible with achieving economic efficiency for the reason that it restricts free bargaining between stockholders and corporate managers—the real parties to the corporate contract.⁵⁴

In its most enlightened sense, however, corporate contractarianism envisions a "corporate contract" that is bargained for by a simple majority of owners, (stockholders) rather than all the parties (including stockholders) to the corporate contract (the certificate of incorporation).⁵⁵ As applied to alternative entity law, contractarianism envisions partnership and limited liability company agreements that are bargained for to be, in most circumstances, modifiable only upon consent of all the owners—arguably the "correct" contractual paradigm. In this manner, the contractarian theory of a stockholder voice is, in fact, solely the voice of the majority, consisting today of large institutional investors and pension funds. Nonetheless, contractarians would argue that the bargain of the majority on behalf of the stockholders is truer to the purpose of the modern corporation—that duties are owed to stockholders and not other constituencies of the corporate enterprise.

An opposing theory is espoused by the communitarians or anti-contractarians.⁵⁶ According to the communitarians, investor-stockholders are often scattered, unsophisticated, and ignorant when contracting on the issue of fiduciary duties. Even in the case of public offerings, where underwriters are considered to be acting on behalf of the stockholders and the public at large, communitarians posit that underwriters act upon their own self-interest in overpricing securities to investors in order to gain repeat business from corporate issuers. Communitarians thus fear that underwriters will not fairly price any initial contractual limitation on fiduciary duties.⁵⁷

⁵³See Butler, *supra* note 51, for an overview of the contractarian position on corporate fiduciary duties. In arguing that stockholders and corporate managers should be free to bargain the extent, if any, of a managerial fiduciary duty, Easterbrook and Fischel state, "Just as there is no right amount of paint in a car, there is no right relation among managers, investors, and other corporate participants." Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1428 (1989).

⁵⁴See Butler, *supra* note 51, at 90-93.

⁵⁵DEL. CODE ANN. tit. 8, § 102(b)(4) (2001) (allowing modifications of the default rule for the affirmative vote of a majority to be modified by a provision set forth in the certificate of incorporation).

⁵⁶See generally David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373 (1993).

⁵⁷See, e.g., Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165, 1183 (1990).

In addition, communitarians are pessimistic that any "bargaining" of fiduciary duty limitations can occur if the bargaining occurs midstream. To the contractarians, midstream bargaining is answered on a theoretical basis by the fact that the market will discount the initial price of the investment to reflect the risk of a midstream adjustment. The contractarian argument is as follows: If management constructs fiduciary duty limitations that are unfair to stockholders, then the market value of the stock will decrease which will, in turn, cause managers to be susceptible to a hostile takeover. The threat of an unwanted takeover prevents managers from engaging in mismanagement or other forms of corporate misconduct—in this context, in the form of reduced or limited fiduciary duties.

Another concern of the communitarians is that the success or failure of the modern corporation affects many constituencies. These constituencies include: (1) the "money investors," such as stockholders and creditors; (2) "human capital investors," such as employees and some officers or directors; and (3) "remote constituencies," such as consumers, suppliers, and the community at large. To communitarians, since all of these constituencies contribute to the maximization of the success of the corporation, they should be considered within the perimeter of fiduciary duty principles. In response, contractarians counter that the corporation is owned and maintained for the benefit and wealth maximization of the stockholders. Therefore, to the extent stockholders desire to approve charitable campaigns, community involvement projects, scholarship funds, and other community efforts, they are free to do so.

It is important to note that the contractarian concept of private ordering does not rebuff fiduciary duties per se. Instead, contractarians accept "[o]ptimal fiduciary duties . . . [that] approximate the bargain that investors and managers would reach if transaction costs were zero."⁵⁸ This line of thinking accepts state-enacted, "optimal" fiduciary duties as gap-fillers to be used in a default context.⁵⁹ From an economist perspective, if over a significant period of time most stockholders and managers bargain to include fiduciary duties in their contract, use of the default obligations is economical

⁵⁸Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1264 (1982).

⁵⁹See, e.g., Easterbrook & Fischel, *supra* note at 53, at 1433, 1444-45 (arguing that states should enact organic laws that "fill[] in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance"); Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 494 (1980) (suggesting that implied consent may be inferred "by trying to answer the hypothetical question whether, if transaction costs were zero, the affected parties would have agreed").

since future stockholders and managers are saved the cost of negotiating and drafting new duties.⁶⁰ If, however, stockholders and managers wish to limit or nullify the default fiduciary duties, contractarians will enforce the privately negotiated agreement over the application of the gap-filling, tort-based default rules.

The contractarian position of permitting the elimination of mandatory fiduciary duties is said to be largely lost⁶¹ because society is not ready to relieve corporate managers of their fiduciary responsibilities.⁶² In significant part, however, this purist view of the original contractarians was likely doomed by its timing: (1) the height of the takeover era where companies were targeted without regard to enhancing share value due to mismanagement or abusive antitakeover conduct by managers;⁶³ (2) dubious financing through "highly confident" letters, the ultimate collapse of the junk bond market, and Drexel Burnham;⁶⁴ and (3) the marketplace view of the greed and self-interest that fueled the takeover era.⁶⁵ Indeed, during the height of the takeover craze, twenty-five jurisdictions adopted "constituency" statutes so that corporate managers could consider employees, consumers, and the community at large in defending a takeover—the antithesis of a contractarian policy.⁶⁶

In viewing this contractarian-communitarian debate in retrospect, I am surprised that the argument for consensual modification or elimination of default fiduciary duties was not coupled with a case for implying the "safe-harbor" of the contractual covenant of good faith and fair dealing. Essentially, if stripped of its economic wealth maximization principles, the corporate contractarian movement was destined to fail if investors had but one choice—

⁶⁰See generally *supra* note 51.

⁶¹See, e.g., Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 275 (1991) (referring to "the demise of the fiduciary principle in corporate governance").

⁶²For articles expressing varying degrees of conflict with the contractarian position, see Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989); Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375 (1988); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985); John C. Coffee, Jr., Lecture, *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919 (1988).

⁶³See generally BRYAN BURROUGH & JOHN HELYAR, *BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO* (1990) (telling the account of the \$25 billion takeover battle for RJR Nabisco).

⁶⁴Ann E. Conaway Stilson, *"Highly Confident" Letters and Tender Offer Financing*, 35 ST. LOUIS U. L.J. 317 (1991).

⁶⁵See *supra* note 51.

⁶⁶Despite the enactments by neighboring jurisdictions, Delaware refused to adopt a constituency statute.

fiduciary duties or no fiduciary duties. Stated differently, the linchpin of the early contractarian theory was private ordering through the corporate contract without any emphasis upon the contractual duties of good faith and fair dealing to protect parties' bargains. In my opinion, the absence of any presentation of this most fundamental contractual duty renders the original corporate contractarian theory intellectually inconsistent with the very "contractual" principles it was seeking to embrace.

B. *Delaware and the Theory of Contract in Corporate Law*

In 1986, Delaware amended the DGCL to permit a corporation to include a provision in its certificate of incorporation limiting or eliminating the personal liability of a director to the corporation or its stockholders for monetary damages for breach of the fiduciary duty of care.⁶⁷ Section 102(b)(7) was the first amendment by a state to allow stockholders to decide whether corporate directors could be exculpated from monetary liability for a breach of a fiduciary duty. When section 102(b)(7) was originally adopted, critics posited that stockholders in public companies would not opt for this provision and, to the extent they did, that share values and directors' duty of care would decline.⁶⁸ In contrast to the critics' predictions, Fortune 500 companies quickly adopted section 102(b)(7) charter amendments and the stock values either remained neutral or increased. Other jurisdictions rapidly followed Delaware's lead by adopting similar section 102(b)(7) protections. Presently, virtually all publicly held corporations have some form of section 102(b)(7) exculpation provision.

In July 2000, Delaware continued its policy of contractual flexibility in a more modified manner by permitting stockholders, through the certificate of incorporation, or a board of directors, to renounce any interest or expectancy of the corporation in an opportunity to participate in specified business opportunities that are presented to the corporation or one or more of its officers, directors, or stockholders.⁶⁹ By not requiring stockholder action on the renunciation of corporate opportunities, section 122(17) is more contractually limiting than its predecessor. In 2007, a shareholder rights amendment was added to the DGCL. Effective August 1, 2007, section 216(4) was amended to provide that a bylaw amendment adopted by

⁶⁷DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

⁶⁸See generally Thomas C. Lee, *Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and the Erosion of the Directors' Duty of Care*, 136 U. PA. L. REV. 239 (1987).

⁶⁹DEL. CODE ANN. tit. 8, § 122(17) (2001).

stockholders that specifies the number necessary to elect directors cannot be repealed or amended by the board of directors.⁷⁰

Delaware's response in 1986 was not radical. From a historical perspective, Delaware has long embraced a contractual theory of corporate law. For example, it is well settled in Delaware that the corporate charter is a contract between the State of Delaware and the corporation and its stockholders, between the corporation and its stockholders, and between the stockholders "inter sese."⁷¹ It is also well established that due to the contractual nature of the corporate charter, the rights of stockholders are contractual and are thus defined in the certificate of incorporation.⁷²

In addition to the certificate of incorporation, bylaws are considered a contract among the stockholders of a corporation.⁷³ In a very recent opinion by the Delaware Court of Chancery, Vice Chancellor Noble considered conflicting bylaws regarding shareholders' nominations of two candidates for election to the Office Depot board of directors.⁷⁴ The bylaw permitting stockholder proposals of nominees allowed either the stockholders to act through the board of directors or to act separately as stockholders.⁷⁵ In a prior draft of the bylaw, stockholder proposals mandated advance notice for

⁷⁰*Id.* § 216(4). A bylaw amendment adopted by stockholders that specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors. 76 Del. Laws 223 (2007).

In 2007, the General Assembly also amended several substantive provisions of the DGCL. In section 141(d), the DGCL was clarified to provide that with regard to voting, unless otherwise provided in a corporation's certificate of incorporation, if the certificate grants a specific director with greater or lesser voting authority, that authority is applicable to the director's votes in a committee or subcommittee. DEL. CODE ANN. tit. 8, § 141(d) (2008). Also, if a class or series of stock is granted a separate vote in the election of directors, that vote will be by a plurality unless otherwise provided in the certificate or the bylaws. *Id.* § 216(3). In addition to the amendments to the DGCL, the Delaware General Assembly amended the Delaware Constitution to permit the Delaware Supreme Court to hear questions of law certified by the U.S. Securities and Exchange Commission. *See* DEL. CONST. art. IV, § 11(8).

⁷¹*Morris v. Am. Pub. Utils. Co.*, 122 A. 696, 700 (Del. Ch. 1923). *See also* *Voege v. Am. Sumatra Tobacco Corp.*, 241 F. Supp. 369, 373 (D. Del. 1965); *Ellingwood v. Wolf's Head Oil Ref. Co.*, 38 A.2d 743, 747 (Del. 1944); *Aldridge v. Franco Wyo. Oil Co.*, 7 A.2d 753, 758 (Del. Ch. 1939), *aff'd*, 14 A.2d 380 (Del. 1940); *Holland v. Nat'l Auto. Fibres, Inc.*, 2 A.2d 124, 127 (Del. Ch. 1938); *Corbett v. McClintic-Marshall Corp.*, 151 A. 218, 222 (Del. Ch. 1930); *Lawson v. Household Fin. Corp.*, 147 A. 312, 315-16 (Del. Ch. 1929), *aff'd*, 152 A. 723 (Del. 1930); *Gaskill v. Gladys Belle Oil Co.*, 146 A. 337, 339 (Del. Ch. 1929); *State ex rel. Southerland v. U.S. Realty Improvement Co.*, 132 A. 138, 138 (Del. Ch. 1926).

⁷²*Ellingwood*, 38 A.2d at 747.

⁷³*See* *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990); *Levitt Corp. v. Office Depot, Inc.*, No. 3622-VCN, 2008 Del. Ch. LEXIS 47, at *11 (Del. Ch. Apr. 14, 2008), *reprinted in* 33 DEL. J. CORP. L. 579, 584 (2008).

⁷⁴*Levitt Corp.*, 2008 Del. Ch. LEXIS 47, at *2-4, *reprinted in* 33 DEL. J. CORP. L. at 579-80.

⁷⁵*Id.* at *4-5, *reprinted in* 33 DEL. J. CORP. L. at 580-82.

competing director nominations—the bylaw under which the stockholders acted had removed the advance notice language.

In examining the parties' contentions as to whether advance notice should be included in the stockholder bylaw and whether nomination of competing directors is "business," and properly brought before an annual meeting, Vice Chancellor Noble noted that "[c]orporate charters and by-laws are contracts among the shareholders of a corporation,' and the proper interpretation and construction of a contract is a question of law."⁷⁶ Further, the court stated, "Because Delaware adheres to the objective theory of contract interpretation, the court looks to the most objective indicia of that intent: the words found in the written instrument."⁷⁷ Therefore, if the language of the bylaw is "clear and unambiguous," then the plain and ordinary meaning of the words selected by the parties will typically establish their intent.⁷⁸ Mere disagreement as to the meaning of contract terms does not by itself create ambiguity.⁷⁹ If a disagreement or ambiguity occurs in a bylaw, "doubt is resolved in favor of the stockholders' electoral rights."⁸⁰ Applying the plain meaning of the terms to the stockholder bylaw, Vice Chancellor Noble found that no advance notice was necessary and that the nomination of competing directors was "business" properly before the annual meeting.⁸¹

In another application of the Delaware corporate contract theory, Chancellor William Chandler considered a claim by institutional investors who sought to invalidate defendant News Corporation's (News Corp.) extension of its poison pill without a shareholder vote.⁸² On April 6, 2004, News Corp. announced a plan of reorganization that included the reincorporation of News Corp. (an Australian corporation) as a Delaware corporation.⁸³ The reorganization was to be contingent on a stockholder vote of each class of News Corp.'s stockholders voting separately.⁸⁴ Rupert Murdoch and his family

⁷⁶*Id.* at *11, reprinted in 33 DEL. J. CORP. L. at 584 (quoting *Centaur Partners*, 582 A.2d at 928).

⁷⁷*Id.* at *16, reprinted in 33 DEL. J. CORP. L. at 586 (quoting *Sassano v. CIBC World Mkts. Corp.*, 948 A.2d 453, 462 (Del. Ch. 2008)).

⁷⁸*Levitt Corp.*, 2008 Del. Ch. LEXIS 47, at *16, reprinted in 33 DEL. J. CORP. L. at 586.

⁷⁹*Id.*

⁸⁰*Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd.*, 924 A.2d 228, 239 (Del. Ch. 2007).

⁸¹*Levitt Corp.*, 2008 Del. Ch. LEXIS 47, at *27, reprinted in 33 DEL. J. CORP. L. at 590.

⁸²*UniSuper Ltd. v. News Corp.*, No. 1699-N, 2005 Del. Ch. LEXIS 205, at *1 (Del. Ch. Dec. 20, 2005), reprinted in 31 DEL. J. CORP. L. 1186, 1187 (2006).

⁸³*Id.* at *2, reprinted in 31 DEL. J. CORP. L. at 1187.

⁸⁴*Id.*

together beneficially owned sufficient stock to prevent the reorganization if they voted as a class to reject it.⁸⁵

In the summer of 2004, the Australian Council of Super Investors, Inc. (ACSI)⁸⁶ and Corporate Governance International (CGI)⁸⁷ met with News Corp. management to discuss the reincorporation.⁸⁸ At these meetings, ACSI and CGI expressed concern about the impact of the reincorporation on stockholder rights, especially the right of the directors to adopt a poison pill without shareholder approval upon News Corp.'s reincorporation in Delaware, whereas the same act could not be accomplished under Australian law without shareholder approval.⁸⁹ To that end, ACSI and CGI proposed a "Governance Article" that contained several shareholder protection provisions, including one that would require a vote on the adoption of a poison pill by News Corp., subsequent to its reincorporation.⁹⁰ The Governance Article was offered for inclusion in the certificate of incorporation of the new Delaware corporation.⁹¹

Despite these efforts by ACSI and CGI, News Corp. informed ACSI in September 2004 that the provisions included in the Governance Article would not be adopted and that there would be no further negotiations.⁹² Thereafter, ACSI issued a press release explaining the background of the negotiations and its belief that the suggested reincorporation would result in a loss of stockholder protections.⁹³ The ACSI press release was widely circulated and had the impact of rousing institutional support in favor of ACSI and against News Corp.⁹⁴

In October 2004, News Corp. decided to reopen negotiations with ACSI.⁹⁵ All the suggestions in the ACSI/CGI Governance Article were ultimately resolved with the exception of the poison pill.⁹⁶ On this latter point, News Corp. alleged that there was insufficient time to institute an amendment

⁸⁵*Id.*

⁸⁶"ACSI is a non-profit organization that advises Australian pension funds on [matters of] corporate governance." *UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *3, *reprinted in* 31 DEL. J. CORP. L. at 1187.

⁸⁷CGI is a proxy advisory firm. *Id.* at *3, *reprinted in* 31 DEL. J. CORP. L. at 1188.

⁸⁸*Id.*

⁸⁹*Id.*

⁹⁰*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *4, *reprinted in* 31 DEL. J. CORP. L. at 1188.

⁹¹*Id.*

⁹²*Id.* at *4-5, *reprinted in* 31 DEL. J. CORP. L. at 1188.

⁹³*Id.* at *5, *reprinted in* 31 DEL. J. CORP. L. at 1188.

⁹⁴*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *5, *reprinted in* 31 DEL. J. CORP. L. at 1188.

⁹⁵*Id.*

⁹⁶*Id.* at *5-6, *reprinted in* 31 DEL. J. CORP. L. at 1188-89.

to the certificate of incorporation.⁹⁷ The alternative suggestion was that the poison pill be addressed through the adoption of a "board policy."⁹⁸

On October 6, 2004, the terms of the parties' agreement were made public in a News Corp. press release, stating:

The [News Corp.] Board has adopted a policy that if a shareholder rights plan is adopted by the Company following reincorporation, the plan would have a one-year sunset clause unless shareholder approval is obtained for an extension. The policy also provides that if shareholder approval is not obtained, the Company will not adopt a successor shareholder rights plan having substantially the same terms and conditions.⁹⁹

After the press release, News Corp. emailed the terms of the "deal" to ACSI, confirming "the board's policy to hold a shareholder vote on twelve-month old poison pills."¹⁰⁰ At the same time, News Corp. sent a letter to its stockholders and option-holders, stating:

The board . . . has established a policy that if any stockholder rights plan (known as a "poison pill") is adopted without stockholder approval, it will expire after one year unless it is ratified by stockholders. This policy will not permit the plan to be rolled over for successive one-year terms on substantially the same terms and conditions or to the same effect without stockholder ratification.¹⁰¹

Approximately two weeks after News Corp. sent the letter to stockholders and option-holders, both groups voted in favor of the reorganization.¹⁰² In November 2004, after the vote to approve the reorganization, a potential hostile acquirer, in tandem with a third party, announced its acquisition of more than seventeen percent of News Corp.'s voting stock.¹⁰³ News Corp. responded to this announcement by adopting a poison pill that it disclosed in a

⁹⁷*Id.* at *8, reprinted in 31 DEL. J. CORP. L. at 1189.

⁹⁸*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *5-6, *8, reprinted in 31 DEL. J. CORP. L. at 1188-89.

⁹⁹*Id.* at *9-10, reprinted in 31 DEL. J. CORP. L. at 1190.

¹⁰⁰*Id.* at *10, reprinted in 31 DEL. J. CORP. L. at 1190.

¹⁰¹*Id.*, reprinted in 31 DEL. J. CORP. L. at 1190-91.

¹⁰²*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *10-11, reprinted in 31 DEL. J. CORP. L. at 1191.

¹⁰³*Id.* at *11, reprinted in 31 DEL. J. CORP. L. at 1191.

November 8, 2004, press release.¹⁰⁴ In the press release, News Corp. also announced that it may or may not honor the earlier "board policy," depending upon whether the managers considered the policy appropriate at the time.¹⁰⁵ One year later, the board breached the agreed upon "board policy" by extending the poison pill without a stockholder vote.¹⁰⁶

Upon these facts, Chancellor Chandler was faced with the decision of whether the press release and letter, upon which the stockholders relied and thereafter voted, created protected contract rights or, as the News Corp. management asserted, were simply the pronouncement of a board policy that was intended to have the revocable effect of a board resolution.¹⁰⁷

In resolving this query, Chancellor Chandler stated,

If the board has the power to adopt resolutions (or policies), then the power to rescind resolutions (policies) must reside with the board as well. An equally strong principle is that: If a board enters into a contract to adopt and keep in place a resolution (or a policy) that others justifiably rely upon to their detriment, that contract may be enforceable, without regard to whether resolutions (or policies) are typically revocable by the board at will.¹⁰⁸

Chancellor Chandler continued, "Once the corporate contract is made explicit on a particular issue, the directors must act in accordance with the amended corporate contract. There is no more need for the gap-filling role performed by fiduciary duty analysis."¹⁰⁹

¹⁰⁴*Id.*

¹⁰⁵*Id.*

¹⁰⁶*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *11, reprinted in 31 DEL. J. CORP. L. at 1191.

¹⁰⁷*Id.* at *15-16, reprinted in 31 DEL. J. CORP. L. at 1192-93. See also *In re Gen. Motors (Hughes) S'holder Litig.*, No. 20,269, 2005 Del. Ch. LEXIS 65 (Del. Ch. May 4, 2005), reprinted in 31 DEL. J. CORP. L. 1066 (2006). In *General Motors* Chancellor Chandler stated:

As opposed to the rights . . . set out in GM's Restated Certificate of Incorporation, which is binding upon the GM board, *there is no information* in the Complaint with respect to the extent to which the GM board was bound to protect the rights . . . granted by the Policy Statement. *If* the Policy Statement had *the effect* of a resolution adopted by the board, it *presumably* could be rescinded or amended by nothing more than another board resolution.

Id. at *13 n.34, reprinted in 31 DEL. J. CORP. L. at 1071 n.34 (emphasis added).

¹⁰⁸*UniSuper Ltd.*, 2005 Del. Ch. LEXIS 205, at *20, reprinted in 31 DEL. J. CORP. L. at 1194.

¹⁰⁹*Id.* at *33, reprinted in 31 DEL. J. CORP. L. at 1199 (citing EASTERBROOK & FISCHER, *supra* note 51, at 92-93) ("Because the fiduciary principle is a rule for completing incomplete bargains in a contractual structure, it makes little sense to say that 'fiduciary duties' trump *actual* contracts.").

C. Lessons to be Learned

It is clear that Delaware corporate law has embraced a contractual theory of the corporation since the early 1920s.¹¹⁰ The Delaware contractual model has focused primarily upon the certificate of incorporation (the province of the stockholders), the corporate bylaws (controlled by stockholders and/or the board of directors), and board resolutions or policies if a board intends to be contractually bound to those policies (the board of directors). In addition, Delaware has adopted amendments to the DGCL that permit shareholders to release directors from personal liability arising from a breach of the duty of care in a corporation's certificate of incorporation.¹¹¹ Also, case law from 2006 to 2007 involving the fiduciary duty to creditors now makes clear that corporate directors may be exculpated for a breach of a duty to creditors where a corporation is insolvent and the suit does not allege self-dealing.¹¹² Other amendments continue to place more contractual freedom in the hands of the corporation and its stockholders.¹¹³

¹¹⁰See *supra* note 71.

¹¹¹See DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

¹¹²See Conaway, *supra* note 17. It is not clear whether the corporate duty to creditors should be applicable to Delaware alternative entities. If the duty is found by the Delaware Supreme Court to be applicable to unincorporated entities, however, a logical argument must be made for potential contractual elimination where Delaware courts have found the duty to be one in which the creditor stands in the shoes of *the stockholders—or the residual risk-bearers*. Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 790-91 (Del. Ch. 2004). Thus far, 2008 has witnessed interesting Delaware Court of Chancery decisions involving the appropriate standard of review on preliminary motions for section 102(b)(7) exculpation claims. See *In re Lear Corp. S'holder Litig.*, No. 2728-VCS, 2008 Del. Ch. LEXIS 121, at *41-42 (Del. Ch. Sept. 2, 2008) ("Courts [when examining actions by an independent board] should therefore be extremely chary about labeling what they perceive as deficiencies in the deliberations of an independent board majority over a discrete transaction as not merely negligence or even gross negligence, but as involving bad faith."); *McPadden v. Sidhu*, No. 3310-CC, 2008 Del. Ch. LEXIS 123, at *33 (Del. Ch. Aug. 29, 2008) (finding, on motions to dismiss, that the management's actions amounted to a showing of gross negligence sufficient to rebut the business judgment rule and that "Delaware's current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason" and thus within the parameters of section 102(b)(7)'s exculpatory protections); *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN, 2008 Del. Ch. LEXIS 125, at *3 (Del. Ch. Aug. 29, 2008) (denying interlocutory appeal on claim by defendants that the Delaware Court of Chancery "improperly conflated possible violations only of the Board's duty of care (i.e., gross negligence) with a violation of the good faith component of the duty of loyalty"); *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN, 2008 Del. Ch. LEXIS 105, at *48 (Del. Ch. July 29, 2008) (denying defendants' motion for summary judgment on grounds that the record did not clearly demonstrate the board's good faith discharge of its fiduciary duties).

¹¹³DEL. CODE ANN. tit. 8, § 216(4) (2001) (permitting stockholders to adopt a bylaw regarding votes necessary for the election of directors and that bylaw may not be amended or repealed by the board of directors).

Yet, from an overall perspective, Delaware's corporate law could learn some lessons from its alternative entity counterparts in the arena of contract theory and application. Perhaps the most significant features that are missing from the DGCL are as follows: (1) a statutory policy of freedom of contract to brace the corporate contract; (2) the ability to modify, expand, or eliminate duties, including fiduciary duties; and (3) the imposition of an irrevocable "floor" of the implied contractual covenant of good faith and fair dealing by corporate managers.¹¹⁴

These suggestions are not radical. Indeed, the original corporate contractarians sought to permit the elimination of mandatory fiduciary duties in favor of standardized, gap-filling fiduciary duties. The suggested template permits default fiduciary duties, but would add three elements. First, the template would permit contractual freedom by stockholders to modify, expand, or eliminate fiduciary duties as they desire. Because the template is contractually based, the implied contractual duties of good faith and fair dealing would inhere in the performance and execution of all corporate contracts. Finally, to buttress the enforceability of corporate contracts, Delaware should recognize a statutory policy of freedom of contract. Once this contractual regime is recognized, stockholders (and stakeholders) are more likely to utilize their voting franchise to implement original or midstream terms, knowing that a Delaware court will enforce those terms according to the contractual duties of good faith and fair dealing.

A second, and equally important, result of a contractual corporate regime is that stockholders will have the power to determine which managers should receive exculpation—directors only, or directors and officers—and whether expert advisors to corporate management should be considered in the "umbrella" of enterprise exculpation. Under section 145 of the DGCL, a Delaware corporation may indemnify a director, officer, employee, or agent.¹¹⁵ Given the traditional usage of "agents" and agency principles in corporate law,¹¹⁶ however, a corporation that wishes to indemnify its outside advisors

¹¹⁴Each of these elements are available in the Delaware alternative entity acts.

¹¹⁵DEL. CODE ANN. tit. 8, § 145(a) (2001).

¹¹⁶Interestingly, with regards to a corporation, another duty is in play—that of an agent to its principle. For example, an officer is an agent to the corporation and a proxy may also create an agency relationship. See RESTATEMENT (THIRD) OF AGENCY § 3.12(2) (2006) ("A power to exercise voting rights associated with securities or a membership interest may be conferred on a proxy through a manifestation of actual authority. The power may be given as security . . . and may be made irrevocable in compliance with applicable legislation."); see also DEL. CODE ANN. tit. 8, § 212(e) (2001) ("A duly executed proxy shall be irrevocable if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally."). See also *Parshalle v. Roy*,

through the doorway of agency under section 145 should clearly indicate that purpose.¹¹⁷

The policy for suggesting contractual flexibility with regard to and including the modification or elimination of fiduciary duties, in addition to liabilities, is that the present corporate scheme only protects directors. Consider, for example, a corporation that retains outside counsel, an accounting firm, an investment banker, and an appraiser. The outside "experts" are needed because the officers of the corporation have expressed concern about the future financial stability of the corporation. Having listened to the advice of the chief financial officer, the chief executive officer, and the president of the corporation (who, in the aggregate have seventy-five years experience with the business), the board of directors seeks to obtain outside advice. After months of disclosures and meetings, the board of directors selects to dissolve under the DGCL. A lawsuit is filed by creditors, wherein it is alleged that the directors breached their duty to the enterprise by not filing a bankruptcy petition in order to forestall creditor claims while the company could reorganize.

Assume that after trial, the Delaware Court of Chancery finds that the directors were grossly negligent in deciding to dissolve under state law. If the certificate of incorporation has a section 102(b)(7) provision, the directors will escape personal liability for their actions, so long as there is no claim of self-dealing or bad faith. Where does that leave the officers, attorneys, accountants, investment bankers, and appraisers who established fiduciary relationships with the directors? In most modern complaints, these parties are named as aiders and abettors for knowingly participating in the directors' conduct that constituted a breach of fiduciary duty.¹¹⁸ Since the directors were found liable,

567 A.2d 19, 27 (Del. Ch. 1989) (holding that a proxy itself must show evidence of a agency relationship); *Rice & Hutchins, Inc. v. Triplex Shoe Co.*, 147 A. 317, 322 (Del. Ch. 1929) ("A person acting as a proxy for another is but the latter's agent and owes to the latter the duty . . . of a fiduciary relationship . . ."), *aff'd*, 152 A. 342 (Del. 1930).

According to the Restatement, the duties of an agent are more stringent than those owed by directors, who are not agents of a corporation. RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006). From this observation, is it reasonable to conclude that corporate law has developed so as to "read out" agency duties as being too rigid for managers of public corporations operating in the global marketplace? If so, how far is the leap to permit modification of fiduciary duties?

¹¹⁷*See, e.g., Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 160, 171 (Del. Ch. 2003) (applying more restrictive definition of agent; interpreted it to not include an outside attorney, where no specific contract between attorney and the corporation exist regarding reimbursement of litigation expenses).

¹¹⁸*See, e.g., Sample v. Morgan*, 935 A.2d 1046 (Del. Ch. 2007); *Forsythe v. ESC Fund Mgt. Co. (U.S.)*, No. 1091-VCL, 2007 Del. Ch. LEXIS 140 (Del. Ch. Oct. 9, 2007), *reprinted in* 33 DEL. J. CORP. L. 239 (2008); *Twin Bridges Ltd. P'ship v. Draper*, No. 2351-VCP, 2007 Del. Ch. LEXIS 136 (Del. Ch. Sept. 14, 2007); *La. Mun. Police Employees Ret. Sys. of La. v. Crawford*, 918 A.2d 1172 (Del. Ch. 2007); *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007); *Teachers' Ret. Sys. v. Aidinoff*, 900 A.2d 654 (Del. Ch. 2006); *Khanna v. McMinn*, No. 20,545-NC, 2006 Del.

these "secondary participants" face aiding and abetting liability as well as breach of fiduciary duties under the rules of professional responsibility. Should stockholders have a right to eliminate a duty of care, while simultaneously imposing a contractual duty of good faith and fair dealing, so that primary and secondary participants have no liability in the absence of bad faith?

If the answer to this query is simply no—meaning that public stockholders should never be permitted to eliminate fiduciary duties—then the response is unsophisticated. The prevailing view that public stockholders today are too scattered, ingenuous, and not knowledgeable enough to comprehend the unintended consequences that could flow from an elimination of any fiduciary duty is naive.¹¹⁹ Consider the following: In 2007 alone, Delaware welcomed Blackstone LP after a public offering wherein investors were clearly apprised of their altered rights and duties under traditional fiduciary law.¹²⁰ Fortress Group, LLC, a new public alternative entity, also chose Delaware as its choice of jurisdiction for formation. Since the market is clearly becoming more aware of the attractiveness of public LLCs and LPs, what would prevent a public corporation, through a simple majority vote, from converting into a Delaware LLC or LP and from there exercising the contractual rights to eliminate duties and liabilities? If the result can be achieved indirectly, why not offer a direct market opportunity? The market will not act irrationally.

Also consider the new B Corporation or other B entity. If Delaware is committed to funding a wind farm with renewable tax credits that can trade on Wall Street, how will such a business's organic document appear?¹²¹ Will the owner or operator be a purpose-driven and benefits-driven organization complete with an authenticity certification and formation document amendment to include nonowner stakeholders? If Delawareans consider a geo-friendly, alternative energy source business "good business," will the legislature

Ch. LEXIS 86 (Del. Ch. May 9, 2006); *McGowan v. Ferro*, 859 A.2d 1012 (Del. Ch. 2004), *aff'd*, 873 A.2d 1099 (Del. 2005).

¹¹⁹*See* Dodd, *supra* note 51 (describing theory that the modern corporation does not exist solely for its stockholders).

¹²⁰*See supra* note 7.

¹²¹On June 25, 2008, the Delaware General Assembly passed Senate Bill 328—an energy bill that clears the way for Delmarva Power and Bluewater Wind LLC to complete a project to provide offshore wind-generated electricity. Aaron Nathans & Ginger Gibson, *Minner Signs Offshore Wind Legislation*, NEWS J., June 26, 2008, at B1. Delaware's Governor, Ruth Ann Minner, signed the Bill on the evening of June 25, 2008. *Id.* Under current Delaware law, utilities must use renewable power for twenty-percent of their supply by the year 2019. Jeff Montgomery, *Lawmakers Hope to Pass Energy Bill by End of Session*, NEWS J., June 25, 2008, at A8. Under the contract between Delmarva and Bluewater Wind LLC, Delmarva will buy 200,000 renewable energy credits (for each unit of electricity that is produced, one tax credit is received), and Bluewater will receive 400,000 tax credits to sell. Aaron Nathans, *Bluewater Ready to Go on Wind Farm*, NEWS J., June 25, 2008, at A8. The renewable tax credits will trade on Wall Street. *Id.*

consider amendments to the DGCL to allow these B entities to redefine their fiduciary responsibilities and the persons to whom their "business judgment" should apply? And, with these new stakeholders, for whom do managers "manage" their wind farm or other "green" business if the financial projections head south in the first few years of the business?

Certainly the marketplace in 2008 is not the same as that which existed when Professors Berle and Dodd debated for whom the corporate machinery runs.¹²² From the perspective of sponsors choosing an original organizational form, the statistics clearly indicate that the freedom of contract offered by Delaware alternative entities is a market premium that will only increase.¹²³ It also appears that in time, "good business" or "environmental business" will come to embrace contradictory constituents—stockholders desiring short-term wealth maximization and nonstockholders seeking long-term benefits, as well as protection to the community and the environment.¹²⁴ The question for Delaware is: Will Delaware corporate law become flexible when the new, contract and environment-driven market hits our border, or will the alternative entity bar become the environmentalists of our future?

IV. CONCLUSION

The market for public alternative entities in Delaware is either the harbinger of change or an aberration of short duration. For those in the industry, many suggest that the present trend in public unincorporated entities will continue and could likely increase. If the trend reflects market desires in the choice of entity, the flexibility that alternative entities provide, including tax savings or environmental credits, then public corporations should consider these attributes as modern corporate law moves forward.

Since contractually eliminating a board of directors is not a viable solution in the next decade of corporate law, legislative drafters might contemplate what contractual flexibility is possible within the contractual public corporate regime. I have suggested: (1) the ability to define, limit, or eliminate fiduciary duties in a certificate of incorporation; (2) the addition of a policy of freedom of contract and the contractual policing techniques offered in that regime; and (3) the recognition of the application of the implied

¹²²John Donne was the Barrister of Lincoln's Inn, London in 1624. Donne also served as the minister in the Chapel at Lincoln's Inn where he delivered his now-famous sermon from the Seventeenth Meditation, stating, "[Don't ask] for whom the bell tolls; it tolls for thee." This information was provided by Peter Castle, Esq., Barrister of Lincoln's Inn, London, 2007-2008.

¹²³Unlike its corporate counterpart in Delaware, LLCs have increased in formation filings every year since the enactment of the Delaware LLC Act in 1992.

¹²⁴*See supra* notes 10-14 (regarding the B Corporation).

contractual covenant of good faith and fair dealing. These suggestions allow stockholders to craft the operation of a management team, along with its outside advisors according to the risks that the stockholders are willing to accept on behalf of the business. In no event would contractual bad faith or illegal conduct escape liability. Since it appears that stockholders may be able to achieve these same results indirectly, through a conversion to an alternative entity, it is logical to consider adding the direct consequences to the arsenal of corporate contractual rights sooner, rather than later.