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Corporate Law's Distributive Design

*Minorities, Shareholder and Otherwise*¹ makes two novel claims: that corporate law places protection of minority shareholders at the heart of its endeavor; and that this minority-mindfulness should have even greater purchase in constitutional contexts. My retelling of the corporate law narrative coupled with my extension of that story to the constitutional domain puts pressure on scholars either to dispute my characterization of corporate law (or for that matter, constitutional law) or to deny the relevance of that characterization to the constitutional sphere. Alternatively and, I think, more promisingly, it allows scholars to seek to understand or resolve law's inconsistent attitudes towards minorities in different domains.

I am glad to have the wisdom of Steven Bainbridge, Richard Delgado, and Kevin Johnson in thinking through my boundary-transgressing endeavor. Dean Johnson extends my thesis, arguing that immigrants, too, present the kind of vulnerable minorities who might deserve legal solicitude, but observing that the courts, through the plenary power doctrine, have disabled themselves from providing such protection. Delgado meanwhile presses for an explanation for the puzzle I identify: why does constitutional law neglect minorities while corporate law embraces them? He locates the divide in majoritarian self-interest.

Bainbridge, on the other hand, challenges my characterization of corporate law as being minority focused. Because his paper, unlike the others, disagrees with fundamental aspects of my argument, I will focus this reply to his claims, reserving the others for consideration in future work. Part I rebuts Bainbridge's case analysis, demonstrating that the cases show clear judicial succor for minority (by which I mean non-controlling) shareholders. Part II turns to broader theoretical differences.

1. Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119 (2003).

CASES

Bainbridge identifies cases that he believes show that corporate law tolerates discrimination among shareholders (*Unocal Corp. v. Mesa Petroleum Co.*,² *Moran v. Household Int'l., Inc.*,³ and *Zahn v. Transamerica Corp.*⁴); allows “selfish ownership” (*Wilkes v. Springside Nursing Home, Inc.*⁵); has attenuated concern for fairness in public corporations (*Sinclair Oil Corp. v. Levien*⁶); and permits non-sharing of control premia (e.g., *Treadway Companies, Inc. v. Care Corp.*⁷). In this part, I review these cases to show that they in fact support my thesis.

Take *Moran*, in which the Delaware Supreme Court upheld a poison pill against a minority shareholder attack. Bainbridge argues that the court’s rebuff to *Moran* shows its willingness to tolerate discrimination against minority shareholders. But Household’s board instituted the poison pill after it learned that *Moran*, chairman of Household’s largest shareholder, had considered leading a leveraged buy-out of Household. The court upheld the defensive measure as a means to stave off “coercive two tier tender offers”⁸ that might exploit the other shareholders.⁹

When *Unocal* instituted a defense that excluded hostile acquirer and minority shareholder *Mesa* from a self-tender by *Unocal*, *Mesa* complained that the board was discriminating amongst different classes of shareholders. The court upheld the discrimination as a reasonable mechanism to prevent a two tier tender offer, in which the second tier would consist in junk bonds, “stamped[ing] shareholders into tendering at the first tier, even if the price is inadequate.”¹⁰ Indeed, the court cited studies showing that shareholders often benefited from the defeat of hostile takeovers.¹¹

To the extent that *Moran* and *Unocal* demonstrate a court’s willing to tolerate discrimination against a class of shareholders, it is simply a willingness of the court to deal skeptically with potentially controlling shareholders whom

2. 493 A.2d 946 (Del. 1985).

3. 500 A.2d 1346 (Del. 1985).

4. 162 F.2d 36 (3d Cir. 1947).

5. 353 N.E.2d 657 (Mass. 1976).

6. 280 A.2d 717 (Del. 1971).

7. 638 F.2d 357, 375 (2d Cir. 1980).

8. *Moran v. Household Int'l., Inc.*, 500 A.2d 1346, 1356 (Del. 1985).

9. *Id.*

10. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 956 (Del. 1985).

11. *Id.* at 956 n.11.

the board, acting with independence and with due care, believes are hostile to the interests of the firm's other shareholders.

In *Zahn*, the court held that the corporation's directors—"puppet[s]" to Transamerica's "puppeteer"¹²—had failed in their duty to "represent[]" all the stockholders."¹³

Corporate law does not offer succor to every shareholder who owns less than fifty percent of the corporation, especially when the minority shareholder seeking the court's protection intends to become the controlling shareholder through a hostile takeover (or receive greenmail to stop trying). Courts understand which shareholders truly need legal protection.¹⁴ Given rational apathy, in a diffusely held corporation, a single large minority owner may wield disproportionate influence in the company. Corporate law is not color-blind; relations of domination and subordination matter; the identity of the parties is legally relevant.

Bainbridge argues that *Wilkes* affirms the possibility of "selfish ownership" by majority shareholders. He makes two crucial omissions in this reference: (1) the rest of the sentence; and (2) the rest of the decision. The court required that any "selfish ownership" of majority shareholders must be "balanced against their fiduciary obligation to the minority."¹⁵ The court sided with minority *Wilkes*, holding that the majority could have followed "an alternative course of action less harmful to the minority's interest."¹⁶ Even though the bylaws allowed the directors to set the salaries, the court held that *Wilkes* had been unjustly removed from the payroll.

Bainbridge for his part says that I neglected to mention parts of the holding in *Sinclair Oil* in which the court upholds the majority shareholder's actions. Indeed, *Sinclair* prevailed against the minority's claim of excessive dividends and missed business opportunities because the minority could not show any harm to the company (and thus its minority shareholders) arising out of the dividends or the firm's expansion policy. In dismissing this part of the minority's claim, the court observed that the minority received its "proportionate" share of the dividend.¹⁷ No harm, no foul. This victory for the controlling shareholder does not undermine my argument. My claim is not that the minority shareholder always wins, and on all counts. Being a minority shareholder is not some sort of talisman that guarantees success at the bar.

12. *Zahn v. Transamerica Corp.*, 162 F.2d 36, 46 (3d Cir. 1947).

13. *Id.* at 45.

14. Chander, *supra* note 1, at 175-77.

15. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

16. *Id.*

17. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721 (Del. 1971).

Bainbridge highlights the sale of control cases, which generally permit the controlling shareholder to retain a premium upon the sale.¹⁸ While Berle and others argued in favor of a sharing rule,¹⁹ the law generally permits “owners of controlling blocs [to] sell at a substantial premium, without any obligation to share the bounty with other shareholders.”²⁰ But this does not disprove my thesis. Corporate law permits controlling shareholders to earn premia because such a position generally makes minority shareholders better off. An active market for corporate control—fostered by control premia—is one of the principal means of disciplining management. Bainbridge himself writes in his impressive treatise that a “no sharing rule should facilitate replacement of inefficient incumbents.”²¹ Some find “strong empirical support for the view that the value of the noncontrolling shareholders’ shares increases following a transfer of control.”²² If a sharing rule dampened the disciplinary force of the market for corporate control, minority shareholders might be worse off in the long run. Yet another feature of the case law protects minority shareholders during changes of control: if a minority shareholder complains, judges carefully scrutinize the transaction for evidence of looting or usurpation of corporate opportunities.

THEORY

To locate occasional cases that fail to protect minority shareholders is not to defeat my thesis. After all, no theory can satisfactorily explain all cases, and there will be differing views as to whether a loss for minority shareholders in one case may hold long-term benefit for minority shareholders overall. Judges might also get a particular decision ‘wrong.’ My point is that the overarching explanation for judicial action in corporate law matters can generally be found in the simple goal of protecting minority shareholders. Corporate law is not minority-status blind.

Consider the universe of persons who are the principal subjects of corporate law: directors, officers, controlling shareholders, and minority

18. One of Bainbridge’s citations for the general rule is inapposite: the sale of stock at issue in *Treadway* “did not transfer control.” *Treadway Companies, Inc. v. Care Corp.*, 638 F.2d 357, 377 (2d Cir. 1980).

19. JAMES D. COX & THOMAS LEE HAZEN, *COX & HAZEN ON CORPORATIONS* § 12.01 n.2 (2d ed. Supp. 2002) (collecting law review articles on the subject).

20. FRANK EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 109 (1996).

21. STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 349 (2002).

22. COX & HAZEN, *supra* note 19, at § 12.01 .

shareholders. Corporate law imposes fiduciary duties on all of these persons with the exception of minority shareholders (unless they are also controlling shareholders). Bainbridge's colleagues have recently argued for the imposition of fiduciary duties on activist, minority shareholders, highlighting this lacuna.²³ *Minorities* suggests that this lacuna is not accidental—but that the duties themselves can be understood as flowing towards minority shareholders.

Bainbridge denies the existence of “significant extra-contractual protections for minorities.”²⁴ But how then does Bainbridge explain fiduciary duties, which, along with limited liability, form the core of corporate law? What are these other than extra-contractual duties placed on directors, officers, and controlling shareholders? There might be some out there who would eliminate fiduciary duties entirely, collapsing corporate law into limited liability and, maybe, securities regulation, but that is not our law today. To argue alternatively that fiduciary duties represent merely the contract that one would have found were it not for market failures and to conclude from this that fiduciary duties are thus not “extra-contractual” is simply to rewrite the meaning of “contract”—and seems especially hard to justify in the setting of closed corporations with few principals.

Bainbridge also contests my analogy, saying that the constitutional domain should properly be squared with the *public* corporation domain, not with the law of closed corporations, thus declaring closed corporation cases to be inapposite to my argument. He argues that closed corporations often involve consensus-based decisionmaking, rather than the authority-based decisionmaking prevalent in public corporations. But it is the lack of ready exit that motivates the heightened fairness concerns and judicial policing in closed corporation settings, not the supposed consensus-nature of the decisionmaking. “No exit” is true of the constitutional domain as well, and thus, I argue, should lead us to be similarly concerned with domination and fairness in constitutional quarters.

Bainbridge's critique leads me to revisit a carelessly worded footnote defining affirmative action.²⁵ I do not believe that corporate law seeks to distribute disproportionately large gains to the minority; corporate law may devote its own resources disproportionately towards minority protection, but it

23. Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008).

24. Stephen M. Bainbridge, *There Is No Affirmative Action for Minorities, Shareholder and Otherwise*, in *Corporate Law*, 118 Yale L.J. Pocket Part 71 (2008), <http://thepocketpart.org/2008/10/28/bainbridge.html>.

25. Chander, *supra* note 1, at 120 n.3.

certainly does not require that minorities get a disproportionate share of the corporate spoils.

CONCLUSION

My back and forth with Bainbridge suggests that there is room to wonder what corporate law is all about. It is best not to adopt uncritically any given orthodoxy, even when it is as appealing as the simple maximand of shareholder wealth. My thesis in *Minorities* might go further—that shareholder wealth maximization is wrong as a descriptive matter; the telos of corporate law is shareholder wealth distribution. The business judgment rule immunizes so much foolishness²⁶ that it is hard to assert that courts play an active role in promoting wealth maximization. Rather it might be more reasonable to assert that judges simply police the distribution of the corporate gains (and make sure that management is not grossly negligent).

Corporations have proven to be remarkably successful forms of enterprise because of or despite a legal framework attentive to the most vulnerable among those contributing capital. Ultimately, through *Minorities*, I hope to spur the thought that human organizational forms stand to learn much from each other.

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26. See, e.g., *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).