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CONSIDERING STAKEHOLDERS IN M&A

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Does a corporation exist to serve its shareholders or its stakeholders? Delaware corporate law emphasizes shareholder primacy, the idea that corporations exist to create value for shareholders. Meanwhile, Benefit Corporation legislation and corporate constituency statutes are rooted in stakeholder theory, the idea that corporations can sacrifice profits to create value for non-shareholders. Indeed, the debate on the purpose of a corporation is contemporary and unsettled. Many prominent players in business and law—such as BlackRock Chairman Larry Fink, Senator Elizabeth Warren, and Martin Lipton—have recently and resoundingly advocated for a stakeholder-oriented governance model.

This Note examines the landscape of states with constituency statutes to better understand how courts and corporations grapple with stakeholder theory in the M&A context. While courts in states with constituency statutes rely on the business judgment rule when evaluating takeovers, the business judgment rule cannot adequately protect stakeholders when a company is up for sale because directors are in their final period with the firm. Directors who are in their final period with the firm do not face repercussions for their culminating actions with the firm and, as a result, are tempted to act selfishly. Delaware courts recognized in Revlon *and its progeny that the business judgment rule is inapt when a company is up for sale precisely because of this "final period problem." Unfortunately, Delaware's solution–requiring boards to choose the highest bid–is incompatible with stakeholder theory and cannot guide courts in states with constituency statutes or Benefit Corporation legislation.*

This Note proposes a necessary alternative to the business judgment rule that courts should use to protect stakeholders and their expectations in certain M&A contexts, such as when a company is up for sale. The proposed framework advises that courts look at the contractual relationships

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between stakeholders and corporations. Since stakeholders and corporations enter into relational contracts that are mostly incomplete, courts can and should gap-fill by inquiring into these parties' post-investment reasonable expectations. This Note concludes that courts ought to closely consider the expectations of employees, short-term creditors, suppliers that make firm-specific investments, customers that rely on continuing their relationships with firms, and communities when assessing an impending takeover because these stakeholders are unable to adequately protect themselves by explicitly contracting with firms.

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INTRODUCTION

On August 19, 2019, the Business Roundtable released a new statement on the purpose of a corporation.[1] The statement was signed by 181 prominent chief executive officers, including Jeff Bezos of Amazon and Jamie Dimon of JPMorgan Chase.[2] According to the statement, corporations exist to create value for all stakeholders, including customers, employees, suppliers, communities, and shareholders.[3] This new philosophy supersedes the shareholder-oriented governance model that had been promulgated by the Business Roundtable since 1997.[4]

The Business Roundtable's statement is the latest commentary in a century-long debate[5] on the purpose of a corporation. Shareholder primacists, like Milton Friedman,[6] claim that corporations must maximize wealth for shareholders before considering stakeholders' interests. Stakeholder theo-

1. BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION 1 (2019).

2. *Id.* at 2–12.

3. *Id.* at 1. While the statement did not mention creditors, this was likely an oversight. Creditors are, without controversy, essential stakeholders in the modern corporation. They are usually among the first stakeholders mentioned by the various judges and academics who discuss stakeholders.

4. BUS. ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE 3 (1997) (asserting that "the paramount duty of management and of boards of directors is to the corporation's stockholders").

5. The origins of shareholder primacy in the modern corporation can be traced back to Arbuckle v. Woolson Spice Co., 1901 WL 708, at *2 (Ohio Cir. Ct. Jan. 12, 1901) ("The real object and purpose of a corporation for profit is to make a profit and to make dividends for the stockholders, and a person who holds the stock of a company has a right to have the business of the company conducted, as far as practicable at least, so that it will make profits and pay dividends."). The Michigan Supreme Court popularized shareholder primacy many years later in Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919). For more analysis on this case, see *infra* Section II.A.1.

6. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sep. 13, 1970, at 6.

rists, like Martin Lipton,[7] claim that corporations can sacrifice shareholder profits to better serve non-shareholder constituents.

The importance of the shareholder-stakeholder dilemma cannot be overstated. Leo Strine, a former Chief Justice of the Delaware Supreme Court, called it an issue that "must be tackled if our system of corporate governance is to work better for society" and a "substantial policy dilemma."[8] Strine is not alone.[9] The debate is often referred to as the most essential in corporate law, and for a good reason: it prompted the enactment of corporate constituency statutes, perhaps the most significant change to United States corporate law since the 1930s.[10]

While the debate is far from settled, stakeholder theory is gaining unprecedented traction in the business world due to mounting pressures from (1) non-shareholders, (2) shareholders, and (3) politicians. Non-shareholders increasingly advocate for corporations to consider their social interests by engaging in employee[11] and consumer[12] activism. The rise in

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7. Martin Lipton et al., *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, WORLD ECON. F. 6 (Sept. 2, 2016).

8. Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term*, 66 BUS. LAW. 1, 1–2 (2010).

9. *See, e.g.*, David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 183 (2013) ("This is more than an important issue. It is the most important issue in corporate law, and one of the most important questions in contemporary social organization."); Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 973 (1992) (referring to constituency statutes as "potentially revolutionary").

10. *See id.*

11. For instance, on September 20, 2019, Amazon employees staged a walkout in protest of the company's inaction on climate change. It was the first walkout in the company's history. Ahiza Garcia, *Amazon Workers Walk Out to Protest Climate Change Inaction*, CNN (Sept. 20, 2019), https://www.cnn.com/2019/09/20/tech/amazon-climate-strike-global-tech/index.html.

Google employees more regularly engage in employee activism. On November 1, 2018, over 20,000 Google employees around the world protested how the company handled executive-level sexual harassment. One labor professional remarked that "[t]he numbers and level of coordination involved in the Google strike was unprecedented." Jillian D'Onfro, *Google Walkouts Showed What the New Tech Resistance Looks Like, With Lots of Cues from Union Organizing*, CNBC (Nov. 3, 2018), https://www.cnbc.com/2018/11/03/google-employee-protests-as-part-of-new-tech-resistance.html.

non-shareholder activism can be at least partially attributed to the growing influence of millennials, who now represent approximately 50% of the workforce[13] and drive 30% of retail sales.[14] Millennials, born between 1983 and 1994, invest their time and money in corporations that prioritize employees, society, and the environment over generating profits.[15] There is empirical evidence to suggest this is not a just fad, but a trend.[16] Generation Zers, born between 1995 and 2002, are also mindful of conscious capitalism. Corporations are finding that they must engage more actively with stakeholders in order to connect with the next generation of employees and consumers.[17]

Shareholders have similarly pressured corporations to reconsider shareholder primacy.[18] In a powerful open letter to CEOs, Blackrock Chairman Larry Fink encourages companies

12. For instance, on January 28, 2017, taxi drivers in the New York City area protested President Trump's Muslim Ban by not picking up people from JFK Airport. Uber decided to turn off surge pricing at the airport. Consumers thought this undermined the strike and campaigned to #DeleteUber. Over 200,000 users deleted the application. Brian Feldman, *The Lessons of #DeleteUber*, N.Y. MAG (Feb. 3, 2017), https://nymag.com/intelligencer/2017/02/the-lessons-of-deleteuber.html.

13. KPMG, MEET THE MILLENNIALS (2017), https://home.kpmg/content/dam/kpmg/uk/pdf/2017/04/Meet-the-Millennials-Secured.pdf.

14. Christopher Donnelly & Renato Schaff, *Who Are the Millennial Shoppers And What Do They Really Want?*, ACCENTURE (2019), https://www.accenture.com/us-en/insight-outlook-who-are-millennial-shoppers-what-do-they-really-want-retail.

15. *See* DELOITTE, THE DELOITTE GLOBAL MILLENNIAL SURVEY 2019 15 (2019), https://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html.

16. Bernhard Schroeder, *How Generation Z Is Creating the Opportunity of a Lifetime. Pay Attention As This is Not a Fad but a Deep Long-Lasting Trend.*, FORBES (Sept. 13, 2019), https://www.forbes.com/sites/bernhardschroeder/2019/09/13/how-generation-z-is-creating-the-opportunity-of-a-lifetime-pay-attention-as-this-is-not-a-fad-but-a-deep-long-lasting-trend.

17. *See* Tracy Francis & Fernanda Hoefel, *'True Gen': Generation Z and its Implications for Companies*, MCKINSEY (2018), https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/true-gen-generation-z-and-its-implications-for-companies.

18. *See, e.g.*, Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter; Cyrus Taraporevala, *We Need Stakeholder Capitalism to Achieve a Sustainable and Inclusive Future*, LINKEDIN (2019), https://www.linkedin.com/pulse/we-need-stakeholder-capitalism-achieve-sustainable-cyrus-taraporevala

to "exercise leadership on a broader range of issues" and to "build a better framework for serving all [] stakeholders."[19] Indeed, many shareholders have divested from corporations that do not look beyond profits: for instance, the University of California system, which holds over $80 billion in assets, has embraced conscious capitalism by divesting from fossil fuel companies.[20] Investors continue to apply pressure by lobbying companies to disclose environmental, social, and governance (ESG) metrics so that they can base investment decisions on how corporations serve their stakeholders.[21]

The captivating shareholder-stakeholder debate has also gained political momentum. In August 2018, Senator Elizabeth Warren proposed the Accountable Capitalism Act, which would require all corporations in the United States with over $1 billion of annual revenue to consider the interests of stakeholders.[22] Martin Lipton's *The New Paradigm* is a similar framework that would require companies to be managed in the public interest.[23] These proposals have inspired ordinary people

19. Fink, *supra* note 18.

20. Umair Irfan, *The University of California System is Ending its Investment in Fossil Fuels*, VOX (Sept. 18, 2019), https://www.vox.com/2019/9/18/20872112/university-california-divestment-fossil-fuel-climate-change. In total, institutional investors have committed to divesting $11 trillion from fossil fuel companies.

21. *See* Ann M. Lipton, *Not Everything is About Investors: The Case for Mandatory Stakeholder Disclosure*, YALE J. ON REG. (forthcoming); Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO L.J. 923, 925 (2019); Gregory Unruh et al., *Investing for a Sustainable Future*, M.I.T. SLOAN MGMT. REV., May 2016, at 3 (explaining that while investors increasingly prioritize ESG, companies have been slow to share ESG metrics and sustainability strategies).

22. Accountable Capitalism Act, S. 3348, 115th Cong. (2018). Ralph Nader advocated for similar legislation throughout the 1970s. *See* Corporate Democracy Act of 1980, H.R. 7010, 96th Cong. (1980). He also co-authored a famous work on corporate accountability that was the foundation of his legislation and was particularly influential in the political sphere. *See* RALPH NADER, MARK GREEN, & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 75–131 (1976).

23. *See* Lipton et al., *supra* note 7. Both Warren's solution and Lipton's solution embrace stakeholder theory; however, Warren's solution relies on the federalization of big public corporations, while Lipton's solution is private-sector and undoubtedly more trustful of corporations. *Compare* NADER, GREEN, & SELIGMAN, *supra* note 22 (arguing that strong federal regulation of public corporations is necessary because businesses are inherently abusive and irresponsible) *with* Martin Lipton, *Corporate Governance – The New Para-*

to reconsider the purpose of the corporation. The stakeholder–shareholder debate continuously resurfaces in a multitude of contexts.

While stakeholder theory is gaining traction in the corporate world and is the rule of law in the many states that have enacted corporate constituency statutes,[24] there is little known about its practical implications. There is also concern about its viability. More specifically, critics assert that stakeholder theory affords too much power to companies' boards of directors. When the board can choose which stakeholders' interests are most important, it "could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own."[25] If stakeholder the-

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digm: A Better Way Than Federalization, WACHTELL, LIPTON, ROSEN & KATZ (Aug. 17, 2018) (arguing "that corporations and investors and asset managers can forge a meaningful and successful private-sector solution").

24. The following states have corporate constituency statutes: Arizona, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, Virginia, Wisconsin, and Wyoming.

One crucial state is missing: Delaware. According to Secretary of State Jeffrey Bullock, "Delaware remains the home of the vast majority of top U.S. companies, including more than two thirds of the Fortune 500 and 80 percent of all firms that go public." JEFFREY W. BULLOCK, DEL. DIV. OF CORPS., A MESSAGE FROM THE SECRETARY OF STATE – JEFFREY W. BULLOCK 1 (2018), https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2018-Annual-Report.pdf.

While Delaware does not have a traditional corporate constituency statute, it has enacted Benefit Corporation legislation. DEL. CODE ANN. tit. 8, §§ 361–68 (2020). Corporations that use the Benefit Corporation form must consider the interests of stakeholders. Other states that have passed Benefit Corporation legislation include: Arizona, Arkansas, California, Colorado, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Utah, Vermont, Virginia, West Virginia, and Wisconsin. *See* BENEFIT CORP INFO. CENTER, STATE BY STATE LEGISLATIVE STATUS (last visited Oct. 30, 2019), https://benefitcorp.net/policymakers/state-by-state-status.

25. Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001); *see also* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 248 (2002) (discussing why "a decision maker cannot

ory is to be viable in the real-world, these agency costs must be addressed.

The mergers and acquisitions ("M&A") context, discussed in this Note, magnifies concerns about the viability of stakeholder theory because takeovers affect virtually all constituencies for both the target and acquiring companies and their interests are often conflicting.[26] For example, if a takeover will cause an employee layoff, the company's shareholders and creditors will probably support the takeover, while its employees and the community will probably not. Takeovers often have dozens of tradeoffs like this. As a result, the board of directors faces its biggest challenge in the M&A context because the stakes are immensely high and all stakeholders want their interests considered.

Unfortunately, courts in states with constituency statutes have universally defaulted to the business judgment rule when assessing impending takeovers.[27] However, the business judgment rule cannot adequately protect stakeholders' interests or expectations in certain M&A contexts, like when a company is up for sale.[28] When the board puts the company up for sale, directors are in their final period with the firm. Final period directors are tempted to act selfishly, realizing that their actions will probably not have future consequences. While Delaware law recognized in *Revlon v. MacAndrews & Forbes Holdings, Inc.*[29] that the business judgment rule is inapt when a company is up for sale, courts in states with constituency statutes have

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make rational choices without some overall single dimensional objective to be maximized").

26. Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 IOWA J. CORP. L. 103, 132 (2003).

27. *See infra* Section II.B.2.

28. *See infra* Section III.A. When a company is up for sale, some academics blanketly refer to this as "*Revlon*-land." *See, e.g.*, Stephen M. Bainbridge, *The Geography of* Revlon*-Land*, 81 Fordham L. Rev. 3277 (2013); Anthony Bisconti, Note, *The Double Bottom Line: Can Constituency Statutes Protect Socially Responsible Corporations Stuck in* Revlon *Land?*, 42 Loy. L.A. L. Rev. 765, 782 (2008). This Note does not use the term "*Revlon*-land" because it insinuates that *all* directors at companies that are up for sale must follow the holding in *Revlon*, regardless of whether these companies are incorporated in states with constituency statutes.

29. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. 506 A.2d 173, 180 (Del. 1986).

not yet recognized the inappropriateness of the business judgment rule in this context.

This Note addresses this problem by examining a judicial framework that can make stakeholder theory viable when a company is up for sale. It is organized as follows. Part I tracks the shareholder-stakeholder debate in detail by discussing the theoretical rationales for both theories. This Part focuses on the contractarian debate and concludes that stakeholder theory is compatible with the nexus of contracts[30] theory of the firm. This is a critical deduction, as this Note's proposed reform in Part III relies on the tenets contract law.

Part II addresses the legal implications of shareholder primacy and stakeholder theory. The first Section in Part II analyzes Delaware law, looking at its fundamental embrace of shareholder primacy in takeover jurisprudence. The second Section evaluates the M&A legal landscape in states with constituency statutes. Overall, Part II establishes that (1) statutory reform is necessary to make constituency statutes practicable, (2) courts in states with constituency statutes should not apply Delaware law, which is inconsistent with the basic tenets of stakeholder theory, and (3) states with constituency statutes have uncertain and inconsistent takeover jurisprudence.

Part III examines the aforementioned reasonable expectations framework, which courts can use to protect corporate stakeholders in certain M&A contexts, like when a company is up for sale. First, Part III examines why we need a new judicial framework, focusing on the inadequacy of the business judgment rule when a company is up for sale. Second, Part III explains how courts can justify using a reasonable expectations approach by calling attention to contract law and the oppression doctrine. Third, Part III develops the reasonable expectations framework by looking at how stakeholders contract with the firm and how the firm's actions frame stakeholders' expec-

30. The nexus of contracts theory of the firm asserts that the corporation is a collection of contractual relationships between stakeholders. It has gained significant traction in the corporate law world. Economist Ronald Coase is generally credited for devising the theory. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 391 (1937). *See* Stephen Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA. L. REV. 1, 9 (2002) ("The dominant model of the corporation in legal scholarship is the so-called nexus of contracts theory. This model's origins fairly can be traced to Nobel Prize laureate Ronald Coase's justly famous article, The Nature of the Firm.").

tations in M&A. Fourth and last, Part III addresses some potential criticisms of the reasonable expectations approach.

I.
THE ACADEMIC DEBATE: SHAREHOLDER PRIMACY VERSUS STAKEHOLDER THEORY

The shareholder-stakeholder academic debate can be traced back to a series of Harvard Law Review articles that were published in the early 1930s. Adolf Berle argued that "all powers granted to a corporation or the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders."[31] One year later, E. Merrick Dodd argued that corporations have a "social service as well as a profit-making function."[32] Of course, Berle's position is the academic foundation of shareholder primacy[33] and Dodd's position is the foundation of stakeholder theory.[34]

Originally, shareholder primacy was more influential. In 1970, revered economist Milton Friedman famously wrote that the "social responsibility of business [is] to increase its profits."[35] After Friedman became President Ronald Reagan's most trusted economic adviser, shareholder primacy became a

31. Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931). *See also* Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) (responding to E. Merrick Dodd, Jr.).

32. E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932).

33. Shareholder primacy has several monikers. *See, e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 265 (1992) (property conception of the corporation); Joseph L. Bower & Lynn S. Paine, *The Error at the Heart of Corporate Leadership*, HARV. BUS. REV. 50, 52 (May–June 2017) (agency model); Ronald Daniels, *Stakeholders and Takeovers: Can Contractarianism Be Compassionate?*, 43 U. TORONTO L.J. 315, 316 (1993) (referring to shareholder primacists as "non-protectionists").

34. Stakeholder theory also has several monikers. *See, e.g.*, Matthew T. Bodie, *NASCAR Green: The Problem of Sustainability in Corporations and Corporate Law*, 46 WAKE FOREST L. REV. 491, 498 (2011) (constituency theory); Allen, *supra* note 33, at 276 (social entity conception of the corporation); Bower & Paine, *supra* note 33, at 57 (company-centered model); Daniels, *supra* note 33, at 316 (referring to stakeholder theorists as "protectionists").

35. Friedman, *supra* note 6, at 32.

lynchpin of Reaganomics and American capitalism.[36] However, the mounting pressures discussed above[37] and the development of constituency statutes have invigorated stakeholder theory. Consequently, stakeholder theory has gained influence in academic literature over the last two decades.

This Part proceeds by examining common theoretical justifications for shareholder primacy and stakeholder theory. This Part focuses on the contractarian argument because, as discussed, the proposed reform in Part III relies on contract theory. In other words, if the corporation is a nexus of contracts, and the nexus of contracts framework is *only* compatible with shareholder primacy, this Note's proposed M&A reform is illogical. This Part also grapples with influential non-contractarian justifications for shareholder primacy and stakeholder theory.

A. *Theoretical Justifications for Shareholder Primacy*

There are three frequently raised arguments for shareholder primacy. The first argument asserts that shareholders are owed a fiduciary duty because they are contractually entitled to corporations' residual profits.[38] While non-shareholders contract with corporations to receive fixed claims on income, shareholders are entitled to the residual income that remains after the firm has paid its fixed claims to non-shareholders. The decisions that the board makes affect the profitability of the corporation and shareholders profit only when the firm profits. Thus, as a default rule, the board owes a fiduciary duty primarily to shareholders.[39]

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36. *See* David J. Berger, *In Search of Lost Time: What If Delaware Had Not Adopted Shareholder Primacy?*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 48, 49–50 (Steven Davidoff Solomon & Randall Thomas eds., 2019).

37. *See supra* notes 11–23 and accompanying text.

38. For a classic articulation of this argument, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 36–39 (1991) [hereinafter EASTERBROOK & FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW]; Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403–06 (1983) [hereinafter Easterbrook & Fischel, *Voting in Corporate Law*].

39. *See* Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 Yale L.J. 698, 700–03 (1982). Default rules are used to fill in incomplete gaps in contracts and can be modified by the agreement of the parties.

Meanwhile, contractarians argue that the board does not owe a fiduciary duty to non-shareholders for two reasons. First, non-shareholders' fixed claims are largely unimpacted by boards' decision-making.[40] Second, non-shareholders are in a better position than shareholders to contract around fiduciary duties because they explicitly contract with the firm.[41]

Both of these explanations are flawed. To start, non-shareholders' claims are not fixed. When a company does well, its employees expect pay raises, creditors expect diminished insolvency risk, and the community expects to collect more taxes.[42] Shareholders are not the only beneficiaries of a company's success. Decisions made by the board of directors, especially in the high-stakes takeover context, have a tremendous impact on all stakeholders. The assertion that non-shareholders' claims are fixed trivializes this impact.

Furthermore, non-shareholders are not in a better position than shareholders to contract around fiduciary duties. Many non-shareholders, like most customers and communities, do not generally contract with the firm explicitly. Non-shareholders that do explicitly contract with the firm find it challenging to contract into a fiduciary relationship with the board because:

> (1) non-shareholders have little bargaining power, given that they have no way of coordinating contracting efforts;[43]
> (2) non-shareholders do not have the financial means to pay the necessary professional costs to contract into a fiduciary relationship with the board;
> (3) non-shareholders do not know they can contract into a fiduciary relationship with the board; and/or

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40. Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 38, at 403; *see* Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 135–36 (2009).

41. EASTERBROOK & FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 38, at 36.

42. Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1194 (2002).

43. *See* David K. Millon, *New Directions In Corporate Law Communitarians, Contractarians, And The Crisis In Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1379 (1993).

(4) non-shareholders face an uphill battle negotiating with directors, who are comfortable with the already-established legal bounds of shareholder primacy.[44]

Meanwhile, shareholders regularly communicate with management and have become increasingly sophisticated due to the rise of institutional share ownership.[45] Even more, some shareholders—preferred shareholders—explicitly contract with the firm and are in a position to protect themselves from unfair takeovers and capital restructurings.[46] Consequently, non-shareholders are not in a better position than shareholders to contract around fiduciary duties.

In fact, there is no contractual default rule that gives fiduciary duties to shareholders because default rules, by definition, can be overridden by contract, and yet, fiduciary duties, in practice, cannot actually be modified. If the nexus of contracts theory vindicates shareholder primacy, non-shareholders must be able to bargain around fiduciary duties. However, non-shareholders in corporations never have, and probably never will, contract around fiduciary duties because it is essentially impossible for non-shareholders to get the requisite con-

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44. This point revolves around network effects:

> As more people adopt particular corporate contract terms, those terms have more value because benefits accrue around the terms, such as judicial rulings interpreting them and the ability to market the firm's securities because of the terms' general acceptance. Thus, it could be that corporate governance has "locked in" around . . . shareholder primacy, and the network effects of its widespread adoption makes it cost prohibitive for corporations to adopt alternative structures.

Justin Blount, *Creating a Stakeholder Democracy under Existing Corporate Law*, 18 U. PA. J. BUS. L. 365, 414 (2016).

45. *See id.* at 410–13 (remarking that shareholders have become increasingly institutionalized and that institutionalized shareholders in particular value their right to vote); John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO. L.J. 1495, 1498 (1990).

46. William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1839–40 (2013). *But see* Ben Walther, *The Peril and Promise of Preferred Stock*, 39 DEL. J. CORP. L. 161, 183–84 (2014) (arguing that, in practice, preferred stockholders are not protected by their explicit contracts with firms).

sent from shareholders.[47] As a result, shareholder primacy is not a contractual default rule, at least in any traditional sense.

The second argument for shareholder primacy asserts that it is a critical check on the power of the board of directors.[48] This is significant and uncontroversial. The board of directors is comprised of actors who are capable of shirking. A fundamental purpose of corporate law is to limit these agency costs.[49] When the board of directors must consider the company's shareholders, and only its shareholders, the board's duty–to maximize shareholders' wealth–is doctrinally clear. However, when the board has the discretion to consider any of the firm's constituents, the board can use this discretion to serve its own interests.

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47. Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 832–34 (1998) (arguing that the nexus of contracts theory has no connection to the shareholder-stakeholder debate).

According to one study, some corporations contract around the fiduciary duty of loyalty by waiving liability associated with the corporate opportunity doctrine, which typically disallows fiduciaries from personally taking on new business opportunities without first offering them to the company. Gabriel Rauterberg & Eric L. Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1119–40 (2017). Surely, corporate opportunity waivers are an atypical case because Delaware law explicitly gives companies the ability to contract around the corporate opportunity doctrine. Del. Code Ann. tit. 8, § 122(17) (2017); *see also* Andrew Verstein, *Upstream Liability, Entities as Boards, and the Theory of the Firm*, 74 BUS. LAW. 313, 315 n.9 (2019) (referring to corporate opportunity waivers as an "important exception[]" to the general rule that fiduciary duties are mandatory). In addition, while waiver of the corporate opportunity doctrine may support the view that certain elements of fiduciary duties can be contracted around, it does not address whether non-shareholders can contract into fiduciary duties.

Meanwhile, managers in Limited Liability Companies (LLCs) also contract around fiduciary duties. Still, Delaware courts have been unwilling to uphold whether or not managers and members in an LLC have a default fiduciary relationship. Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 856 (Del. Ch. 2012) (claiming this is an issue about which reasonable minds could differ). For an interesting discussion on this and the freedom of contract in LLCs, see David G. Yosifon, *Opting Out of Shareholder Primacy: Is the Public Benefit Corporation Trivial?*, 41 DEL. J. CORP. L. 461, 467–68 (2017).

48. *See* Ian B. Lee, *Efficiency and Ethics in the Debate about Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 567 (2006).

49. *See* John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 18 (1986).

The third argument asserts that boards owe a fiduciary duty to shareholders because shareholders "own" the corporation.[50] Shareholders, whose "*only* economic interests in the firm are residual," are always incentivized to increase the value of the firm.[51] Meanwhile, non-shareholders may not be primarily interested in increasing the economic value of the firm. For instance, creditors will prefer a risk-free project that guarantees that a firm will remain solvent over a project that offers higher expected returns. For this reason, corporations are fundamentally structured around shareholders, who are given the unique ability to vote for directors.[52] These directors are fiduciaries to shareholders and must act in their best interests.

Professor Lynn Stout claims this is the worst argument for shareholder primacy because it is circular.[53] The assertion that shareholders are always incentivized to increase the value of the firm may be true, but there is simply no connection between this and shareholders' voting rights. Proponents of shareholder primacy that think there *ought* to be a connection make a different argument, perhaps rooted in one of the two aforementioned justifications for shareholder primacy. However, the argument that shareholders "own" the corporation, just because they can vote for directors, is tautologous and cannot stand by itself.

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50. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY 78–84 (Routledge 2017) (1932); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1276–80 (1999).

51. Jonathan F. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 VA. L. BUS. REV. 177 (2008); *see* Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 38, at 403–06.

52. Shareholders also have the unique ability to "approve certificate amendments, . . . amend the bylaws, and . . . vote on important transactions such as mergers." Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 766 (2015).

53. Stout, *supra* note 42, at 1190. For an extended discussion on this counterargument, see generally Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 288 (1999) (theorizing that "[c]orporate law does not treat directors as shareholders' agents but as something quite different: independent hierarchs who are charged not with serving shareholders' interests alone, but with serving the interests of the legal entity known as the 'corporation'").

Regardless, shareholders' supposed privileges of ownership are irrelevant given that their influence on corporate decision-making is often diluted and negligible.[54] For instance, unless there is unified and highly-coordinated dissent by shareholders, the board wields essentially all decision-making power within the corporation. Such coordination is rare because it is costly and time-consuming; shareholders can spend three or more years trying to elect directors that represent their interests given that directors often have staggered board terms. As a result, shareholders do not have any special fiduciary relationship with the board just because they own shares in the company.

B. *Theoretical Justifications for Stakeholder Theory*

There are also three frequently raised arguments for stakeholder theory. The first argument is the inverse of the contractarian argument above and asserts that the board is contractually obligated to consider the interests of stakeholders. To reiterate, stakeholder theorists believe the default rule is a myth: there is no special contractual justification for giving shareholders special fiduciary duties.[55] Shareholders and non-shareholders both have variable claims in the corporation. While shareholders invest their money into companies and hope the stock price rises, employees invest their careers into the companies they work for and hope to receive pay raises and promotions. In addition, shareholders are not in a better position than non-shareholders to contract around fiduciary duties. In fact, non-shareholders never have, and probably never will, bargain into fiduciary duties because it is essentially impossible to get the requisite consent from shareholders. Thus, there is no default rule; all stakeholders are on "equal footing" and the board must consider all of their interests.[56]

The second argument asserts that directors should consider stakeholders' interests because a corporation can survive only if its stakeholders are willing to invest in the corporation.[57] Stakeholders invest in corporations hoping to see posi-

54. BERLE, JR. & MEANS, *supra* note 50.

55. *See supra* notes 42–47 and accompanying text discussing flaws of shareholder primacists' contractarian arguments.

56. Eisenberg, *supra* note 47, at 833.

57. *See* Bower & Paine, *supra* note 33, at 58.

tive returns. Corporations fundamentally rely on these stakeholders and their investments. Thus, corporations must ensure that "customers want their products, employees want to work for them, suppliers want them as partners, shareholders want to buy their stock, and communities want their presence."[58] Non-shareholder constituencies are less likely to see positive returns when their interests are subordinate to those of shareholders. Accordingly, non-shareholders that are disenfranchised may limit their investments in the corporation or, if possible, leave the corporation altogether. Therefore, as a communitarian principle, the board ought to consider the interests of all of the company's stakeholders.

The third argument asserts that stakeholder theory is wealth-maximizing for corporations and also for society in the long-run.[59] When management's compensation and job security are tied to shareholder returns, management is eager to meet shareholders' expectations. This pressure incentivizes management to think about short-term financial results. If the pressure to produce short-term financial results is significant enough, management may consider rash courses of action such as shirking and book-cooking. However, when management's compensation and job security are tied to social goals, management can consider the bigger picture. Corporations that adequately consider the effects of its business on society over a long-term investment horizon will be more primed for long-term success. Therefore, stakeholder theory is desirable for corporations and their long-term shareholders.

II.
THE LEGAL FRONT: HOW COURTS HAVE GRAPPLED WITH SHAREHOLDER PRIMACY AND STAKEHOLDER THEORY

This Part examines the legal ramifications of shareholder primacy and stakeholder theory. The first Section discusses Delaware's embrace of shareholder primacy in general corporate law and when a company is up for sale. The second Section surveys the legal landscape in states with constituency statutes and examines how courts in these states have handled takeovers. Courts in states with constituency statutes are doctri-

58. *Id.*
59. *See* Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 61 U. PA. L. REV. 2003, 2016–19 (2013).

nally lost because (1) constituency statutes are drafted poorly, (2) case law is sparse, and (3) these courts cannot always look to Delaware corporate law for guidance.

A. *The Legal Landscape of Delaware*

Three seminal cases establish that shareholder primacy is the rule of law in Delaware:[60] *Dodge v. Ford Motor, Co.*,[61] *eBay Domestic Holdings, Inc. v. Newmark*,[62] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[63] The courts in *Dodge* and *eBay* discuss shareholder primacy in the general corporate law context. Meanwhile, the court in *Revlon*, addressing dicta in *Unocal Corp. v. Mesa Petroleum Co.*,[64] establishes that shareholder primacy is also the norm in the takeover context. In *Revlon*, the court held that when a company is up for sale, the board must sell the company to the highest bidder. The holding in *Revlon*

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60. Delaware law fundamentally requires that directors promote shareholder welfare. Strine, Jr., *supra* note 52, at 768–86; *see also* Stephen Bainbridge, *A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015), https://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/a-duty-to-shareholder-value.

However, some academics contend that the law allows directors to "subordinate what they believe is best for stockholder welfare to other interests, such as those of the company's workers or society generally." Strine, Jr., *supra* note 52, at 764; *see, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 30–31 (2012); Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 325 (2011); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763–69 (2005).

There is one context that Delaware law undoubtedly does not require boards to maximize shareholders' wealth: when a company is in the "vicinity of insolvency." Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991). In this context, the board must pay special attention to the company's creditors and its other constituents. *See* Royce de R. Barondes, *Fiduciary Duties of Officers and Directors of Distressed Corporations*, 7 GEO. MASON L. REV. 45, 63–82 (1998). *But see* Stephen M. Bainbridge, *Much Ado about Little - Directors' Fiduciary Duties in the Vicinity of Insolvency*, 1 J. Bus. & Tech. L. 335 (2007) (arguing that the holding in Credit Lyonnais is limited and is not good for public policy).

61. *Dodge*, 170 N.W. at 668.

62. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).

63. *Revlon*, 506 A.2d at 173.

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

was clarified in several subsequent cases, most notably *Paramount v. QVC Network.*[65]

1. *Establishing Shareholder Primacy*

Shareholder primacy was famously promulgated in the landmark Michigan Supreme Court case *Dodge v. Ford Motor, Co.*[66] In the early 1900s, Ford Motor Company was in an excellent financial position.[67] From 1911 to 1915, Ford rewarded its shareholders by paying out special dividends.[68] However, in 1916, Ford announced that the company would no longer issue special dividends to its shareholders.[69] Instead, all future profits would be invested "to spread the benefits of this industrial system to the greatest possible number [and] to help them build up their lives and their homes."[70] Interestingly, the shareholders that sued wanted to use the special dividends to expand Dodge Brothers Company, a competitor of Ford.[71]

The court held that Ford must pay a special dividend to its shareholders in this context.[72] In so holding, the court paid particularly close attention to Henry Ford's testimony, which discussed the firm's humanitarian motives.[73] The court famously articulated that "[a] business corporation is organized and carried on primarily for the profit of the stockholders."[74] Directors are required to use their powers and discretion to maximize shareholders' wealth and cannot advance any other

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65. Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994).

66. For an excellent exchange discussing the scope, importance, and implications of this case, compare Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008) (arguing that the holding in *Dodge* is limited and maintaining that for-profit corporations in Delaware can still pursue social missions), with Macey, *supra* note 51 (arguing that *Dodge* stands for a general principle that for-profit corporations must maximize shareholders' wealth).

67. *See Dodge*, 170 N.W. at 670.

68. *Id.*

69. *Id.* at 671.

70. *Id.*

71. Of course, Dodge Brothers Company (now known as Dodge, which is a subsidiary of Chrysler) is still around today. For more on the complexities of this case, see Alan M. Weinberger, *Henry Ford's Wingman: A Perspective on the Centennial of* Dodge v. Ford, 14 N.Y.U. J.L. & BUS. 1013, 1027–28 (2018).

72. *Dodge*, 170 N.W. at 681.

73. *Id.* at 684.

74. *Id.*

purposes.[75] Indeed, shareholder primacy as we now know it was born.

Shareholder primacy is still the rule of law in Delaware, as exemplified by the recent seminal case *eBay Domestic Holdings, Inc. v. Newmark.* The facts in *eBay* are eerily similar to those in *Dodge.* In *eBay*, Craigslist and its board of directors wanted to run the company "as a community service."[76] However, eBay, a competitor and minority shareholder in Craigslist, wanted Craigslist to "focus[] on monetizing its site."[77] Craigslist sought to reorganize the company so that it could decrease eBay's influence, and ultimately, run the company to benefit its non-shareholders.[78]

The court held that Craigslist is obligated to "promote the value of the corporation for the benefit of its stockholders" because Craigslist is a for-profit Delaware entity.[79] This corporate form establishes a fiduciary relationship between the board and the company's shareholders. Craigslist's directors breached their fiduciary duty to eBay and its other shareholders because they admitted that they had no interest in maximizing shareholder wealth.[80] Cases like *Dodge* and *eBay* emphasize that shareholder primacy is the rule of law in Delaware.

2. *Applying the Tenets of Shareholder Primacy When a Company is Up for Sale*

Delaware law first tangled with shareholder primacy in the takeover context in *Unocal Corp. v. Mesa Petroleum Co.* In this case, the Unocal board defended against a hostile tender offer by pursuing a self-tender offer.[81] Unocal was not up for sale.[82] The court, using a heightened variation of the business judgment rule, held that the Unocal board's defensive actions were reasonable.[83] In so holding, the court stated that the board *may* be allowed to consider the impact of takeovers on non-

75. *Id.*
76. *eBay*, 16 A.3d at 8.
77. *Id.*
78. *See id.* at 24–25.
79. *Id.* at 34.
80. *Id.*
81. *Unocal*, 493 A.2d at 949.
82. *See id.* at 949–53.
83. *Id.* at 958–59. The standard that the court uses in *Unocal* can also be thought of as a "conditional business judgment rule." Stephen M. Bain-

shareholders, such as creditors, customers, employees, and the community.[84] Delaware's status as a shareholder primacy state was very much in the balance, at least in the takeover context.

This issue was "squarely addressed" in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[85] In this case, Revlon received a hostile tender offer from Pantry Pride that it did not want to accept.[86] The board of directors eventually decided to sell the company to Theodore Forstmann, who offered a significantly lower price than Pantry Pride.[87] The Revlon board justified the sale to Forstmann, the lower bidder, by claiming it would be a better deal for its creditors.[88]

While takeover jurisprudence in Delaware to this point had relied on variants of the business judgment rule,[89] the

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bridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 796 (2006).

84. *Unocal*, 493 A.2d at 956.

85. Strine, Jr., *supra* note 52, at 769.

86. *See Revlon*, 506 A.2d at 175–77.

87. *See id.* at 178–79.

88. *Id.* at 179.

89. *Id.* at 182. The business judgment rule is an essential component of Delaware takeover jurisprudence. The court in Moran v. Household International Inc., 500 A.2d 1346 (Del. 1985) was the first court to prominently use the business judgment rule in the takeover context.

The *Unocal* court's reconstruction of the business judgment rule made takeover jurisprudence more uncertain. On the one hand, the court in *Unocal* relied on the business judgment rule to make its decision and insisted that it "will not substitute its judgment for that of the board if the [board's] decision can be attributed to any rational business purpose." *Unocal*, 493 A.2d at 954. On the other hand, the court added that the board's action must be "reasonable in relation to the threat posed." *Id.* at 949. Academics now refer to this as the "proportionality test." *See, e.g.*, Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review*, 44 BUS. L. 247, 247–48 (1989). The "proportionality test" arguably defeats the purpose of the business judgment rule because it allows courts to scrutinize boards' decisions, effectively giving judges the latitude to substitute their opinions for directors' opinions.

The business judgment rule was again refined in *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995). In this case, the court turned away from the liberal business judgment rule interpretation in *Unocal.* Instead, the court stated that boards' actions must be "draconian" in order for the court to step in and substitute its judgment for the board's. *Id.* at 1386–88. While, in theory, this is still a heightened standard of review from the business judgment rule, in practice, there is not much difference between the two standards. Academics refer to this heightened standard as the "Unocal-Unitrin standard." For an interesting commentary on these standards and

court in *Revlon* did not defer to the business judgment rule. Instead, the court determined that when a company is up for sale, a more restrictive standard of review is necessary because the board ceases to manage the business.[90] In this context, directors are more likely to sacrifice the corporation's interests to advance their own.[91] This is often referred to as the final period problem and is discussed in more detail later in this Note.[92]

The court in *Revlon* ultimately held that the board breached its fiduciary duty to shareholders because it did not accept the highest bid.[93] When the board sells the company to the highest bidder, shareholders' wealth is maximized. Thus, the court in *Revlon* affirmed that the tenets of shareholder primacy apply in the takeover context: "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."[94]

The court's decision in *Revlon* was clarified in subsequent cases. In *Paramount v. QVC Network*, the court addressed concerns about the scope of *Revlon*: "when a corporation undertakes a transaction which will cause: (a) a change in corporate control; or (b) a breakup of the corporate entity, the directors' obligation is to seek the best value reasonably available to the stockholders."[95] The court also submitted that the most valuable bid is not always that with the highest price: boards

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the development of the business judgment rule, see Bainbridge, *supra* note 83.

90. *See Revlon*, 506 A.2d at 182.

91. *See* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 719–22 (2d ed. 1995) (arguing that the final period problem is a serious agency concern and that courts must address it). *But see* Franklin A. Gevurtz, *Removing* Revlon, 70 WASH. & LEE L. REV. 1485, 1561–70 (2013) (arguing that the final period problem does not justify a higher level of judicial scrutiny when a company is up for sale).

92. *See infra* notes 132–134 and accompanying text.

93. *Revlon*, 506 A.2d at 182.

94. *Id.* at 176.

95. *Paramount*, 637 A.2d at 48. It is important to note that the scope and importance of *Revlon* have been called into question by subsequent cases. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015); C&J Energy Servs. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Tr., 107 A.3d 1049 (Del. 2014); Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009).

must also consider the bid's risk, premium, terms, and the structure of the offer.[96] Meanwhile, the court in *In re RJR Nabisco, Inc. S'holders Litig.*[97] held that the board can look at "non-financial" aspects of competing bids if their values are "substantially equivalent."[98]

B. *The Legal Landscape of States with Corporate Constituency Statutes*

There is far less legal certainty in states with constituency statutes. For one, constituency statutes are drafted poorly and do not adequately guide directors or courts. Corporate constituency statutes must be reworked if stakeholder theory is to be viable in the real world. In addition, case law is sparse because corporations have been unwilling to be the guinea pigs that test the bounds of corporate constituency statutes. Lastly, courts in states with corporate constituency statutes cannot look to Delaware for guidance because, as discussed, Delaware has adopted shareholder primacy. Some important Delaware

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Indeed, it is also a hot topic of academic debate. *See* Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161 (2019); *see* James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323 (2018); *see* Lyman Johnson & Robert Ricca, *The Dwindling of* Revlon, 71 WASH. & LEE L. REV. 167 (2014).

However, a recent empirical study concludes that *Revlon* is still alive and well in Delaware:

> [D]eals within *Revlon* result in more protracted negotiations, more rounds of bidding, more bidders, and higher deal premiums. . . . *Revlon* matters in Delaware because Court of Chancery judges take seriously the opportunity to review transactions for reasonableness. And because the judges of the Court of Chancery take it seriously, well-advised parties do so as well. As a result, we find, *Revlon* is reflected in the planning and execution of transactions involving Delaware companies.
>
> Our findings thus reveal *Revlon* as a tool of the judiciary to monitor bias in M&A transactions. *Revlon* orders the transaction process and prevents managers, bankers and lawyers from slacking in the service of shareholders. This account is consistent with *Revlon's* place in corporate law theory as well as its historical development.

Matthew D. Dain et al., *Does* Revlon *Matter? An Empirical and Theoretical Study*, 108 CAL. L. REV. (forthcoming Dec. 2020).

96. *See Paramount*, 637 A.2d at 48.

97. *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036 (Del. Ch. Jan. 31, 1989).

98. *Id.* at *4.

cases, like *Revlon*, simply cannot be squared with stakeholder theory.

Unsurprisingly, the confluence of these factors has led to problematic and makeshift takeover jurisprudence in states with constituency statutes. The majority of courts, like the district court in *Dixon v. Ladish Co., Inc.*,[99] blanketly defer to the business judgment rule in all takeover contexts, even when a company is up for sale. Other courts, like the Seventh Circuit in *Dixon*,[100] sidestep constituency statutes altogether and instead rely on Delaware law or the tenets of shareholder primacy.

1. *Discussing the Uncertainty of the M&A Regime*

a. Poorly Drafted Statutes

The legal landscape of states with corporate constituency statutes is murky, in part because constituency statutes are not drafted well: they are vague and do not adequately guide courts, corporations, or stakeholders.[101] More specifically, it is unclear (1) how these statutes are supposed to be enforced, (2) to whom these statutes apply, and (3) how courts and corporations are supposed to weigh competing interests. Constituency statutes must be reworked if they are to adequately protect non-shareholders.

First, constituency statutes do not provide any enforcement mechanisms and do not otherwise specify how non-shareholders can protect their interests.[102] Some constituency statutes are silent as to enforcement. Other constituency statutes place explicit limitations on the rights of non-shareholders.[103] For instance, New York's constituency statute states that "[n]othing in this paragraph shall create any duties owed by any director to any [stakeholder]. . . ."[104] If constituency statutes are to be practically significant, non-shareholders must be

99. Dixon v. Ladish Co., 785 F. Supp. 2d 746 (E.D. Wis. 2011).
100. Dixon v. ATI Ladish LLC, 667 F.3d 891 (7th Cir. 2012).
101. Bisconti, *supra* note 28 at 796–99.
102. *See* Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85, 117 (1999) (discussing why non-shareholders lack standing under constituency statutes).
103. *See* Bisconti, *supra* note 28, at 783.
104. N.Y. BUS. CORP. LAW § 717(b) (McKinney 1989).

afforded the standing to sue the board so that they can be remediated.

Second, there is also uncertainty regarding to whom constituency statutes apply. Constituency statutes permit, rather than mandate, corporations to consider non-shareholders' interests.[105] In addition, constituency statutes do not require companies to declare whether or not they will consider stakeholders' interests. Thus, a company can shield itself from non-shareholders by asserting it has not adopted stakeholder theory. Likewise, a company can shield itself from shareholders by asserting it has "opted in" to the constituency statute. As a result, the boards of directors at companies subject to constituency statutes have enormous power because they wield the benefits of both shareholder primacy and stakeholder theory. There are obvious opportunities for reform here: corporations should have to elect *ex-ante* whether or not they will consider stakeholders' interests, or alternatively, constituency statutes should mandate that boards consider stakeholders' interests.[106]

Third and last, constituency statutes do not specify how corporations should weigh stakeholders' interests.[107] In theory, a company that exists for its stakeholders cannot accept a higher takeover bid if it is worse for constituencies overall. But how do we measure what is best and worst for constituencies on the whole? May a board sell a company for pennies on the dollar if the company's employees will receive massive pay

105. *See, e.g.*, *id.* (stating that directors "shall be entitled" to consider stakeholders' interests); 15 PA. CONS. STAT. ANN. § 516 (West 1995) (stating that directors "may, in considering the best interests of the corporation, consider the effects of any action" on stakeholders). For many years, Connecticut was the only state with a mandatory constituency statute. However, Connecticut now has a permissive constituency statute. *Compare* CONN. GEN. STAT. ANN. § 33-756 (West 2017) (stating that a director "*may* consider, in determining what he reasonably believes to be in the best interests of the corporation," stakeholders' interests) (emphasis added), *with* CONN. GEN. STAT. ANN. § 33-756 (West 2005) (stating that a director "*shall* consider, in determining what he reasonably believes to be in the best interests of the corporation," stakeholders' interests) (emphasis added).

106. *See* Bisconti, *supra* note 28, at 797–98.

107. Benefit Corporation statutes have the same problem. *See* Sean W. Brownridge, *Canning Plum Organics: The Avant-Garde Campbell Soup Company Acquisition and Delaware Public Benefit Corporations Wandering* Revlon-*Land*, 39 DEL. J. CORP. L. 703, 740–48 (2015).

raises? May a board sell a company to the highest bidder if all of the company's employees will be laid off? Constituency statutes as written do not adequately guide boards of directors because they do not provide a framework to compare stakeholders' interests and expectations. This Note provides such a framework in Section III.C.

b. Sparse Case Law

A second factor contributing to the murky legal landscape in states with constituency statutes is that case law is limited. Indeed, courts are hesitant to apply constituency statutes and corporations are hesitant to rely on them. This is especially the case in the takeover context when a company is up for sale because non-shareholders' interests are monetized.[108] In other words, directors and courts have been tentative to explicitly prioritize non-shareholders over shareholders when the trade-off is obvious.

Let's look at an example to explain this notion. In the non-takeover context, if ABC Inc. is choosing between an environmentally-friendly and an environmentally-harmful course of action, ABC Inc. can assert that the environmentally-friendly course of action is better for its shareholders by hollowly claiming it will bring financial goodwill to the company in the long-term. Thus, in the non-takeover context, a company can claim that what is best for non-shareholders is also best for shareholders, even if there is limited evidence to support the claim.

Now let's examine the takeover context and assume ABC's board of directors puts the company up for sale. Let's also assume there are two bidders: DEF Inc. and GHI Inc. DEF's bid is $15/share and GHI's bid is $10/share. DEF will use a harmful chemical in the merged company's supply chain, while GHI promises to go carbon-neutral. In this context, ABC's board of directors cannot convincingly claim that GHI's lower, but environmentally-friendly, bid is better for its shareholders in the long-run because stock prices reflect firms' earning potentials.[109] The board must explicitly prioritize its

108. Elhauge, *supra* note 60, at 819–20.

109. At one unfortunate point in Delaware corporate law's history, the law allowed managers to block "takeovers on the paternalistic ground that managers could assess the value of expected future profits more accurately than

shareholders by choosing the higher bid or some of its non-shareholders by choosing the environmentally-friendly bid. To date, boards have been hesitant to prioritize non-shareholders over shareholders when the economic tradeoff is evident.[110] Courts have similarly been hesitant to uphold such tradeoffs.

Corporations' usage of anti-takeover devices similarly explains why M&A case law is sparse in states with corporate constituency statutes. Directors and officers often protect their interests in corporations by adopting private defense mechanisms such as the poison pill, the poison put, staggered boards, and golden parachutes. Shareholders have generally been unwilling to contest the legality of these devices in states with corporate constituency statutes because these devices are now par for the course in the corporate world. Nevertheless, even when litigation has arisen, corporations have strategically limited its scope to avoid a discussion about constituency statutes: "[i]f managers can so defend their actions without using constituency statutes, they prefer to do so, as admitting in court that an action is defensible only by reference to groups other than shareholders is not likely to help the corporation's share price."[111] As a result, judicial opinions that assess impending takeovers rarely grapple with constituency statutes.

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the stock market in setting the current stock price, even if shareholders accepting the tender offer thought otherwise." *Id.* at 819; *see* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990).

110. One interesting real-world example of this involves the sale of Ben & Jerry's to Unilever. While Ben and Jerry's, a famously progressive and stakeholder-oriented company, did not want to sell-out to Unilever, the board was concerned about relying on Vermont's corporate constituency statute:

> Notwithstanding the plain language of the law, the board may have been afraid to accept a lower offer (that of socially-oriented Hot Fudge Partners) because the Vermont law was untested in the courts–the board believed that a lawsuit might follow and go all the way to the Vermont Supreme Court where they might eventually lose. The issue was apparently the magnitude of the social discount. The board felt that if bids were close, they could accept the lower bid, but the difference between $38 per share and $43.60 was too high. If the law needed a case to test its limits; Ben & Jerry's declined to be that case.

Antony Page & Robert A. Katz, *Freezing out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 VT. L. REV. 211, 236–37 (2010).

111. Brett McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1232 (2004).

c. Lack of Guidance from Delaware

The third and last factor contributing to the murky legal landscape in states with constituency statutes is that Delaware, "the most important American jurisdiction" for corporate law, has not grappled much with stakeholder theory.[112] As discussed, Delaware law currently centers around shareholder primacy. The holding in *Revlon* requiring that boards accept the highest bid—the bid that is best for shareholders—is incompatible with stakeholder theory.[113]

Meanwhile, although Delaware recently enacted Public Benefit Corporations ("B Corp") legislation that requires certain willing and qualifying corporations to exist for their stakeholders,[114] this is a new development in the law that has not been the subject of much litigation. Stakeholder theory may have more doctrinal certainty if, or rather when, there is an influx of B Corp litigation in Delaware. But for now, states with constituency statutes should not look to Delaware for guidance on M&A jurisprudence. As a result, as we will see in the following section, takeover jurisprudence in these states leaves much to be desired.

2. *Deciphering Shoddy M&A Case Law*

Courts have interpreted constituency statutes in the takeover context using one of two approaches. A majority of courts use the blanket deference approach, deferring to directors' decisions per the business judgment rule in essentially all takeover situations, even when a company is up for sale. These courts recognize that constituency statutes are the rule of law but are tentative to protect stakeholders for the various aforementioned reasons.[115]

112. Strine, Jr., *supra* note 52, at 763.
113. Of course, Delaware law may not forever embrace shareholder primacy. While unlikely, change can come soon. Chief Justice Strine recently retired from the Delaware Supreme Court. Tamika Montgomery-Reeves now serves as an associate justice on the Delaware Supreme Court while Collins Seitz, Jr., a former associate justice, is the new chief justice. Jeff Montgomery, *Seitz, Montgomery-Reeves Picked for Del.'s Post-Strine Era*, LAW360 (Oct. 24, 2019), https://www.law360.com/delaware/articles/1213259/seitz-montgomery-reeves-picked-for-del-s-post-strine-era.
114. DEL. CODE ANN. tit. 8, §§ 361–68.
115. *See infra* Section II.B.1.

Meanwhile, some courts take a sidestepping approach, circumventing constituency statutes altogether. These courts base their holdings on Delaware law or the tenets of shareholder primacy. While courts that take the sidestepping approach often end up employing the business judgment rule, similar to courts that take the blanket deference approach, sidestepping courts contribute to an unfortunate narrative that constituency statutes cannot, and will not, have any "practical effect" on corporate law.[116]

The district court and Seventh Circuit opinions in *Dixon v. Ladish Co.* exemplify this makeshift jurisprudence. In *Dixon*, Ladish's board of directors agreed to sell the company to Allegheny.[117] The value of the offer package, which included stock, was a 59% premium on Ladish's trading price.[118] Ladish's board unanimously approved the deal while its shareholders "overwhelmingly" approved the deal.[119] However, after the deal was announced, Allegheny's stock price dropped, significantly affecting the value of the transaction for Ladish's shareholders.[120] A Ladish shareholder who did not approve the transaction sued Ladish's board.[121] Ladish is a for-profit Wisconsin limited liability corporation and Wisconsin has a corporate constituency statute.[122]

The district court in *Dixon v. Ladish Co.* took the blanket deference approach.[123] The court relied on the business judg-

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116. Richard B. Tyler, *Other Constituency Statutes*, 59 MO. L. REV. 373, 423 (1994). However, even some governance scholars that oppose stakeholder theory as a governance principle acknowledge that constituency statutes *should* practically affect corporate law. *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 583 n.176 (2002) (remarking how corporate constituency statutes "wreak havoc in [sic] the basic normative principles underlying corporate law" and asserting that it is fortunate that "courts seem to be ignoring these statutes. . .").

117. *Dixon*, 667 F.3d at 893.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *See id.*; WIS. STAT. ANN. § 180.0827 (West 2007).

123. This approach was also taken by the district court in *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984 (E.D. Wis. 1989) (holding that the company acted legally when it considered stakeholders' interests because Wisconsin has a corporate constituency statute) and the court in *Georgia-Pacific Corp. v. Great Northern Nekoosa Corp.*, 727 F. Supp. 31, 33 (D.

ment rule and determined that there were no acts of bad faith or other "plausible claim[s] capable of overcoming the rule's presumption."[124] Thus, the district court held that there was nothing improper regarding the board's decision to accept Alleghany's offer.[125] The court also addressed constituency statutes head-on by outlining the rule of law in Wisconsin:

> The Wisconsin Legislature enacted § 180.0827 after *Revlon*, and it specifically authorizes corporate directors to consider more than just shareholders in executing their duties. Such a provision is in direct conflict with a rule that would require directors to focus solely on maximizing value for the benefit of shareholders. Thus, *Revlon* cannot be the rule in Wisconsin. Therefore, in total, the court finds that . . . the business judgment rule applies.[126]

The appellate court in *Dixon* took the sidestepping approach.[127] Judge Frank Easterbrook, writing for the Seventh

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Me. 1989) ("[T]he Directors of a corporation, in considering the best interests of the shareholders and corporation, should also consider the interests of the company's employees, its customers and suppliers, and communities in which offices of the corporation are located."). Interestingly, the court in *Georgia-Pacific* also considered an alternative standard to the business judgment rule:

> Georgia-Pacific argues that reasonableness is the standard by which Great Northern's actions . . . must be judged. [*Unocal* citation] . . . Great Northern argues that the company's actions are presumptively valid under the Business Judgment Rule and that they may only be found invalid if the Board acted fraudulently or in bad faith. Although the Business Judgment Rule may be the more appropriate standard, . . . the Court need not decide the issue now for it is plain that Georgia-Pacific has not shown that the Board's actions in setting the meeting date were even unreasonable.

Id. at 33 n.1. Unfortunately, the court's basis for potentially using a reasonableness standard no longer holds up. While the court in *Georgia-Pacific* leverages *Unocal*, which used a heightened standard of review, this standard was changed several years after *Georgia-Pacific* by the court in *Unitrin*. *See supra* note 89. This Note proposes a reasonableness standard by leveraging contract theory rather than inapplicable Delaware case law. *See infra* Part III.

124. *Dixon*, 785 F. Supp. 2d at 757.

125. *Id.* at 756–57.

126. *Id.* at 753.

127. This approach was also taken by the court in Keyser v. Commonwealth National Financial Corp., 675 F. Supp. 238, 266 (M.D. Pa. 1987) (refusing to uphold constituency statutes in any capacity, deciding that "[t]he

Circuit, completely ignored § 180.0827, Wisconsin's constituency statute. Instead, Judge Easterbrook focused his analysis exclusively on § 180.0828, which outlines the board's fiduciary duties to its shareholders.[128] Judge Easterbrook criticized the "debate in the district court about the scope of *Revlon*," remarking that "there is no need to decide how Wisconsin's courts would apply the common law when there is a statute [outlining directors' fiduciary duties to shareholders]."[129] In the end, like the district court, the Seventh Circuit leveraged the business judgment rule and ultimately held that there was nothing improper about the board's decision to accept Alleghany's offer. However, the Seventh Circuit ignored the possibility that boards can consider non-shareholders' interests, effectively denying that constituency statutes have any influence or effect on corporate law.[130]

III.
An Opportunity for Judicial Reform: The Reasonable Expectations Approach

This Part examines the reasonable expectations approach to determine how courts can better protect non-shareholders. This Part proceeds as follows. The first Section establishes why the reasonable expectations approach is a better judicial standard than the business judgment rule in certain M&A contexts, like when a company is up for sale. Indeed, the business judgment rule does not adequately protect stakeholders' interests or expectations. The second Section explains how courts can justify using the reasonable expectations approach. While this Note recommends that courts leverage contract theory, courts can alternatively use the oppression doctrine, which has traditionally been used to protect minority shareholders in close corporations. The third Section dives into the specifics of the reasonable expectations approach. This Section goes stake-

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extent to which price could be sacrificed for these so called social issues in the factual context of this case is not a proper determination for the court") and the Seventh Circuit in *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989) (Easterbrook, J.) (leveraging Delaware law and upholding the district court's decision, which leveraged the state's constituency statute, on other grounds).

128. *Dixon*, 667 F.3d at 895–96.

129. *Id.* at 896.

130. *See Id.*

holder-by-stakeholder, assessing stakeholders' contractual relationships with firms and their reasonable expectations regarding M&A activity. The fourth and final Section grapples with some anticipated drawbacks of using a reasonable expectations approach. The convincing drawbacks of this approach revolve around the administrative difficulties of balancing stakeholders' expectations.

A. *Why (and When) Should Courts Adopt the Reasonable Expectations Approach?*

While the business judgment rule is an adequate deference mechanism in Delaware law, there are two reasons why the business judgment rule is problematic when directors may consider stakeholders' interests when a company is up for sale. First, the shareholder wealth maximization norm, which underlies the business judgment rule, helps tame selfish director behavior. This norm provides directors with a clear standard that reigns in their discretionary powers. If we "remov[e] the psychological constraint that the shareholder wealth maximization norm provides, . . . we are less likely to encourage directors to pursue the collective interests of the firm's various constituents than to encourage directors to pursue their own self-interest."[131] Thus, the business judgment rule, to some extent, is ill-fitted in states with corporate constituency statutes. At the very least, courts in states with constituency statutes should be hesitant to universally default to the business judgment rule.

131. Bainbridge, *supra* note 116, at 582. It does not seem like stakeholder theory would have any practical effect on directors in takeovers; after all, Delaware courts often defer to boards per the business judgment rule and do not scrutinize directors' decisions on the merits. Even when a board makes a decision in the best interests of a company's stakeholders, courts only intervene when there is evidence of fraud, self-dealing, or the like. *See* Shlensky v. Wrigley, 237 N.E.2d 776, 779 (Ill. App. Ct. 1968) (applying Delaware law); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004) (discussing the relationship between the business judgment rule and governance and explaining why judicial abstention is beneficial). However, even if stakeholder theory does not have an obvious legal impact on the business judgment rule, it is clear that stakeholder theory has a serious psychological impact on directors acting under the business judgment rule. Stephen M. Bainbridge, *In Defense of The Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1440 (1993).

Second, the business judgment rule is impotent specifically when a company is up for sale because directors are in their final period with the firm. In most contexts, directors know they will have to deal with the repercussions of their actions in future transactions.[132] For instance, Judge Posner remarked how "competition in the product and labor markets and in the market for corporate control provides sufficient punishment for businessmen who commit more than their share of business mistakes."[133] However, when the board decides to sell the company, directors' tenures with the company are nearly at an end. There is minimal threat of future punishment, and hence, directors are tempted to self-deal. Of course, Delaware corporate law has addressed this problem in *Revlon* and its progeny:

> The heightened scrutiny that applies in the *Revlon* (and *Unocal*) contexts are, in large measure, rooted in a concern that the board might harbor personal motivations in the sale context that differ from what is best for the corporation and its stockholders. Most traditionally, there is the danger that top corporate managers will resist a sale that might cost them their managerial posts, or prefer a sale to one industry rival rather than another for reasons having more to do with personal ego than with what is best for stockholders.[134]

The reasonable expectations approach, as this Note proposes, would require courts to assess impending takeovers by considering stakeholders' bargains and relationships with

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132. *See* Sean J. Griffith, *Deal Protections in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1941–53 (2003); GILSON & BLACK, *supra* note 91, at 719–22; Ronald J. Gilson & Reinier Kraakman, *What Triggers* Revlon*?*, 25 WAKE FOREST L. REV. 37, 55 n.68 (1990).

133. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 256 (7th Cir. 1986).

134. *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597 (Del. Ch. 2010) (Strine, V.C.); *see* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 458 (Del. Ch. 2011) ("Final stage transactions for stockholders provide another situation where enhanced scrutiny applies. Final stage transactions give rise to what economists refer to as the last period problem."); Lonergan v. EPE Hldgs. LLC, 5 A.3d 1008, 1019 (Del. Ch. 2010) ("In a final stage transaction—be it a cash sale, a break-up, or a transaction like a change of control that fundamentally alters ownership rights—there are sufficient dangers to merit employing enhanced scrutiny.").

companies that were put up for sale. This approach addresses the two aforementioned shortcomings of the business judgment rule. First, the reasonable expectations approach does not rely on a norm of shareholder wealth maximization; instead, it embraces stakeholder theory by calling attention to stakeholders' relationships with and investments in the corporation. Second, the framework calls for increased scrutiny of directors' actions when they are particularly tempted to self-deal. Indeed, the framework gives all vulnerable stakeholders legal recourse to protect their reasonable expectations in the company's affairs.

The reasonable expectations approach also provides other advantages over the business judgment rule. Most notably, this approach empowers stakeholders. If courts evaluate boards' decisions on the merits, directors will be incentivized to communicate with stakeholders, assess their reasonable expectations, and provide them with information about impending takeovers.[135] In addition, this approach "encourages [a] comprehensive review of behavior patterns over time, rather than a cursory inspection of isolated events."[136] This tailored and inquisitive approach is fitting in the takeover context because stakes are high and stakeholders are vulnerable.

B. *How Should Courts Justify Using the Reasonable Expectations Approach?*

There are two ways courts can justify using a reasonable expectations approach. While these justifications have differ-

135. Several academics have called for corporations to adopt stakeholder democracies to formalize stakeholders' involvement with the board. *See* Blount, *supra* note 44, at 381–405. However, even the most stakeholder-friendly firms have been unwilling to contract into a stakeholder democracy. In addition, in the United States, there have been no realistic pushes to legally mandate stakeholder democracies. While Germany's codetermination corporate governance model, which gives employees considerable power on the board of directors, has been mostly successful, there are several reasons why it would not work in the United States. *See* Mark G. Robilotti, *Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARV. INT'L L.J. 536, 549–53 (1997). Most importantly, stakeholder democracy "makes powerful financial intermediaries, who act undemocratically, more politically palatable in Germany than they are in the United States." *Id.* at 552.

136. Ralph A. Peeples, *Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 NOTRE DAME L. REV. 456, 503 (1985).

ent remedies, tools, and consequences, courts can feasibly use either basis to protect stakeholders from exploitation in M&A.[137]

First, courts can leverage the nexus of contracts theory.[138] Courts have the authority to fill in open contractual terms when contracts between corporations and stakeholders are incomplete. By adopting gap-filler terms, courts can crucially exercise their power and discretion to ensure stakeholders are not taken advantage of in the course of contracting. After all, gap-filling solves an information asymmetry problem: "when one party to a contract knows more than another, the knowledgeable party may strategically decide not to contract."[139] In other words, the corporation–the knowledgeable party–will strategically neglect or ambiguate certain contractual terms when it contracts with stakeholders. Courts must gap-fill to "encourage the parties to reveal information to each other or to third parties (especially the courts)."[140]

Nevertheless, not all contractual relationships between shareholders and corporations are explicit: some contracts are implied-in-fact or relational. Relational contracts are informal, long-term, ongoing, and mostly incomplete arrangements.[141] The contractual rights of parties in a relational contract may be "openly adjusted during the relationship," regardless of whether the parties offer additional consideration.[142] Rela-

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137. *See generally* Douglas K. Moll, *Reasonable Expectations v. Implied-In-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989 (2001) (providing a more detailed discussion on the distinction between contract law and the oppression doctrine).

138. *See supra* notes 38–47 and accompanying text (discussing why the nexus of contracts theory of the organization is compatible with stakeholder theory).

139. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 127 (1989).

140. *Id.* at 91. Academics refer to this as a penalty default rule, which is "designed to give at least one party to the contract an incentive to contract around the default rule and therefore to choose affirmatively the contract provision they prefer." *Id.*

141. William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 446–57 (1989); Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 753–63 (2002); Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 271 n.1 (1992).

142. Moll, *supra* note 141, at 756.

tional contracting is particularly necessary in the takeover context as "to prevent the more powerful party—the corporation—from using its superior bargaining power in ways that illegitimately threaten the interests of [stakeholders] relying on continuation of the relationship."[143] This Note considers this contractual approach in the following Sections, given that U.S. courts tend to emphasize parties' contractual relationships.[144]

Second, courts can justify using the reasonable expectations approach by leveraging the oppression doctrine, which has traditionally been used to benefit minority shareholders in close corporations.[145] In many close corporations, directors are also the majority shareholders. This confluence of power leaves minority shareholders vulnerable to freeze-outs and squeeze-outs.[146] Director-shareholders are able to pay themselves exorbitantly while siphoning the earnings of minority shareholders. Meanwhile, minority shareholders are unable to protect themselves by selling their stock on an open market. As a result, courts have established a fiduciary duty owed by

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143. Joseph W. Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611, 656 (1988). Professor John Coffee, Jr. takes this one step further by asserting that takeovers overhaul the stakeholder-corporation contractual relationship. He argues that employees that form implicit contracts with the firm forego earnings to invest in ongoing job security and future compensation. *Cf. infra* note 149. However, when there is a takeover, employees' implicit bargains for job security and deferred compensation cannot be honored. Thus, shareholders opportunistically and strategically seek takeovers, reneging stakeholders' implicit contracts with the firm, to transfer wealth from stakeholders to themselves. Coffee, Jr., *supra* note 49, at 24. In a later work, Coffee writes about how "the appropriate response should be not to bar takeovers, but to spread the premium so as to compensate the 'losers.'" John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435, 465 (1988).

144. *See* Paul Schwartz, Comparative Contractual Privacy Law: The U.S. and EU (Oct. 10, 2015) (unpublished manuscript), https://www.law.uchicago.edu/files/file/schwartz_comparative_contractual_privacy_law.pdf (remarking how, in the United States, explicit and implicit contractual arrangements are the basis of privacy law while, in the European Union, courts have "limit[ed] the unbridled use of contract").

145. Moll, *supra* note 141, at 723–27.

146. Squeeze-outs refer to takeovers in which majority shareholders eliminate minority shareholders by coercing them to sell their stock. Freeze-outs refer to takeovers in which majority shareholders use their influence to eliminate certain investment benefits, like dividends, that minority shareholders rely on. *See* Moll, *supra* note 141, at 723–27.

the majority shareholders to the minority shareholders in close corporations.

Stakeholders in widely held companies are similarly vulnerable when a company is up for sale. Like minority shareholders in close corporations, stakeholders in widely held corporations are at risk of having their earnings siphoned when there is a takeover. Takeovers often involve corresponding transfers of wealth from defenseless stakeholders to shareholders and executives who negotiate for "golden parachutes."[147] In addition, non-shareholders generally have no open-market recourse, as they cannot sell their bargains or relationships with the corporations.[148] Employees, for instance, acquire firm-specific skills that are not readily marketable to other corporations.[149] Indeed, for precisely these reasons, Canadian corporate law protects certain stakeholders by allowing them to bring oppression claims in change of control transactions.[150] States with constituency statutes can follow suit.

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147. *See* Caleb N. Griffin, *The Hidden Cost of M&A*, 2018 COLUM. BUS. L. REV. 70, 108–09 (2018); Ken Hanly, *Hostile Takeovers and Methods of Defense: A Stakeholder Analysis*, 11 J. BUS. ETH. 895, 899–901 (1992).

148. There are some minor exceptions. For instance, the syndicated loan market can provide recourse to sophisticated long-term creditors. Regardless, their interests do not need to be protected under this framework. *See infra* Section III.C.3.

149. This is the basis of the implicit contract theory:

> Workers' investments in firm-specific capital and deferred compensation are made not on the basis of some explicit contractual arrangement, but rather take the form of an implicit contract. The implicit contract in the internal labor market is that in the early phases of their career, employees will be paid less than the value of their marginal products and less than their opportunity wage in exchange for a promise of job security and a wage rate that is greater than the value of their marginal products and their opportunity wages later in their working lives. Thus, employees are investing in the firm during their training and high productivity periods, with the expectation of recouping on the investment in their declining years.

Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 51 (1991).

150. *See* BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R. 560 (Can.). The Court also cited several factors that courts could use to assess parties' reasonable expectations, including: "general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and

C. *What is the Reasonable Expectations Framework?*

This Section considers the particulars of the reasonable expectations approach, which allows courts to protect vulnerable stakeholders in M&A. Procedurally, this approach effectively replaces the business judgment rule. If a court determines that an impending takeover does not meet stakeholders' reasonable expectations, it may order an injunction that bars the board from accepting the takeover bid in-question. As discussed, the framework can be most effectively implemented if constituency statutes are reformed to (1) give non-shareholders standing to sue the board and (2) require corporations to opt in or out of the statute, or alternatively, mandate that corporations consider stakeholders and their interests.[151]

This Section practically analyzes which stakeholders in particular need protection from courts and which corporate actions jeopardize these stakeholders' expectations.[152] This

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agreements; and the fair resolution of conflicting interests between corporate stakeholders." *Id.* at para. 72.

151. *See supra* notes 101–107 and accompanying text.

152. This Note focuses on corporate actions rather than corporate declarations of purpose, like mission statements and purpose statements. Sure, corporate declarations of purpose can "clarify which audiences matter to the board[,] introduce clarity about investment and pay-out horizons to investors[,] and clarify what time-horizons the board wants to adopt in the pursuit of its strategies." KEVIN LEVILLAIN ET AL., CORPORATE GOVERNANCE IN CONTENTION 52 (Ciaran Driver & Grahame Thompson eds., 2018). For instance, Ben & Jerry's tripartite mission statement excellently orients stakeholders' expectations because it details its vested interest in the communities it serves, the environment, and its employees:

> [Product mission:] To make, distribute and sell the finest quality all natural ice cream and euphoric concoctions with a continued commitment to incorporating nutritious, natural ingredients and promoting business practices that respect the Earth and the Environment.
>
> [Economic mission:] To operate the Company on a sustainable financial basis of profitable growth, increasing value for our stakeholders and expanding opportunities for development and career growth for our employees.
>
> [Social mission:] To operate the company in a way that actively recognizes the central role that business plays in society by initiating innovative ways to improve the quality of life locally, nationally and internationally.

Our Values, BEN & JERRY'S, https://www.benjerry.com/values (last visited Oct. 30, 2019). Clif Bar is another company that has framed stakeholders' expectations with a corporate declaration of purpose. Clif Bar's articles of

Section's analysis considers companies' relational contracts with shareholders, employees, creditors, suppliers, customers, and the community.[153] In summation, courts need to closely consider the expectations of employees, short-term creditors, suppliers that make firm-specific investments, customers that

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incorporation states that the company may limit its for-profit objectives to "sustain the viability of its business; sustain the working and living morale of the employees; sustain the community; and sustain the planet." Articles of Incorporation, Clif Bar (on file with author).

However, Ben & Jerry's and Clif Bar are anomalies. Companies' mission statements and purpose statements are predominantly ineffective. Most companies' mission statements refer hollowly to making a difference in society without detailing how it plans to do so. Meanwhile, nearly all companies' purpose statements state, *verbatim*, that "[t]he purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of the State of [insert state of incorporation]." *See* Jessica Chu, Note, *Filling a Nonexistent Gap: Benefit Corporations and the Myth of Shareholder Wealth Maximization*, 22 S. CAL. INTERDISC. L.J. 155, 173–74 (2012).

Even if a company does articulate a detailed purpose, the company's actions may deviate from this purpose. For instance, Enron's mission statement famously stated: "We treat others as we would like to be treated ourselves. . . . We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness and arrogance don't belong here." James S. Kunen, *Enron's Vision (and Values) Thing*, N.Y. TIMES (Jan. 19, 2002), https://www.nytimes.com/2002/01/19/opinion/enron-s-vision-and-values-thing.html. When a company's stated purpose is inconsistent with its actions, which is often the case, it is difficult to determine stakeholders' reasonable expectations for the company. As a result, while corporate declarations of purpose can frame stakeholders' expectations *ex-ante*, courts should instead focus on corporations' actual activities and contractual relationships with stakeholders.

153. Professor Joseph Singer posed a series of questions about relational contracting that were helpful in developing this Note's framework:

> What relations have been established? What expectations have been generated on both sides by continuation of the relationship? To what extent should those expectations be protected? What was the explicit agreement between the parties? What is the distribution of power in that relationship? What alternatives do the parties have open to them? How have the parties relied on continuation of the relationship? How have the parties contributed to the joint enterprise? What are the consequences of giving complete control . . . to the putative owner or limiting the corporation's obligations to those agreed to in the contract? What are the consequences of imposing greater obligations on the corporation toward the [stakeholders]? What moral obligations should the more powerful party have in this context to protect the more vulnerable party?

Singer, *supra* note 143, at 658–59.

rely on ongoing relationships with the firm, and communities when assessing an impending takeover because these stakeholders are unable to protect themselves by contracting with firms.

1. *Shareholders*

Shareholders' expectations do not need to be protected by courts because shareholders have appraisal rights. Shareholders wield the ultimate power in takeovers, as they may accept a tender offer or decline it. These appraisal rights allow shareholders to protect themselves by blocking takeovers that do not benefit them. Other stakeholders do not have this ability.[154] If the board wants to sell the company, it must solicit and ultimately choose a bid that shareholders are willing to accept.[155] As a result, when a company is up for sale, shareholders' expectations are inherently considered. This Note does not assess shareholders' reasonable expectations in M&A and neither should courts.

2. *Employees*

Employees' reasonable expectations must be considered by courts when a company is up for sale because most employees cannot effectively contract around the costs they incur in the event of a takeover. Employees generally cannot protect

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154. One rare exception is that employees in employee-owned companies can protect themselves by leveraging their appraisal rights. Publix is one such company in which employees own a majority of the company's stock. As a result, Publix employees can decline tender offers and ultimately determine which, if any, takeover bids the company will accept. *See The Employee Ownership 100: America's Largest Majority Employee-Owned Companies*, NATIONAL CENTER FOR EMPLOYEE OWNERSHIP, https://www.nceo.org/articles/employee-ownership-100 (last visited Oct. 30, 2019); *see also* Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1220–22 (1991) (discussing Employee Stock Ownership Plans and how they protect workers from detrimental takeovers).

155. Shareholders will accept bids only when the bid is greater than some function of "(1) the price that will prevail in the market if the there is no offer, multiplied by the likelihood that there will be none, and (2) the price that will be paid in a future tender offer, multiplied by the likelihood that some offer will succeed." Frank H. Easterbrook & Daniel R. Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733, 1737 (1981).

themselves from takeovers for three reasons. First, approximately 90% of employees are not unionized.[156] As a result, most employees simply do not have the means or legal knowledge to contract around changes in control. Second, employees generally do not have enough influence to bargain for golden, silver, or tin parachutes,[157] which are contractual clauses that require corporations to pay large severance packages to employees who are laid off.[158] Third and last, even when *unionized* employees have negotiated for golden, silver, or tin parachutes, these clauses have generally proven to be unenforceable in M&A as buying corporations are insulated by labor law and the arbitration system.[159] As a result, courts must protect employees' reasonable expectations in M&A.

When a company is up for sale, employees are primarily concerned about three components of their job: their job security, earning potential, and voice in the company. Employees' expectations about their job security are grounded in how the company has dealt with layoffs in the past. Some companies, like FedEx, Aflac, and Toyota, did not lay off employees during the recession in 2008.[160] Other companies, like Lincoln Electric and Nucor, have no-layoff policies.[161] Employees at these companies reasonably expect that their jobs are secure as long as they perform well. Job security is likely an integral reason why employees choose to work and stay at these companies. Indeed, many employees have probably sacrificed some compensation for the corresponding job security.

Accordingly, courts should be skeptical of takeovers that will result in layoffs, especially if the target company has a his-

156. Zach Hrynowski, *What Percentage of U.S. Workers Are Union Members?*, GALLUP (Aug. 28, 2019), https://news.gallup.com/poll/265958/percentage-workers-union-members.aspx.

157. There is not much of a difference between the terms. "Golden parachutes" are given to senior-level executives, "silver parachutes" are given to low-level executives, and "tin parachutes" are given to those below the executive level.

158. *See* Van Wezel Stone, *supra* note 149, at 59–64.

159. Indeed, "successorship clauses," which attempt to bind the buyer to the seller's collective bargaining agreements, are legally unenforceable. *See* Howard Johnson Co. v. Detroit Local Joint Exec. Bd., 417 U.S. 249, 264–65 (1974); Van Wezel Stone, *supra* note 149, at 66–69.

160. *See* Jessica Dickler, *Employers: No Layoffs Here*, CNN MONEY (Dec. 11, 2008), https://money.cnn.com/2008/12/09/news/economy/no_layoffs.

161. *Id.*

tory of not laying off its employees. To assess employees' expectations about layoffs, courts should ask: *Does the Bidder plan on laying off employees? If and when the Target was in a financially precarious position, did it lay off employees? Has the Target laid-off employees in other contexts? Does the Target have an explicit no-layoff policy?*

Employees' expectations about their earning potentials are grounded in how the company has dealt with pay raises and promotions in the past. A recent study looked at relational contracts in the M&A context.[162] The study found that employees worry most about the impact that impending M&A will have on raises and promotions.[163] In addition, the study found that employers are most likely to breach their relational contracts with employees by not granting promised pay raises and promotions.[164]

Given companies' proclivity to renege on promises relating to raises and promotions when there is a takeover and the psychological damage this has on employees, courts should also be highly skeptical of takeovers in which the acquiring company will not honor promised and expected raises and promotions. To assess employees' expectations about their earning potentials, courts should ask: *Is there room for employee growth and promotion at the Target? Were employees at the Target promised pay raises or promotions? Will the Bidder be aware of, and follow through with, the Target's promised pay raises and promotions?*

Lastly, employees have social expectations about their employers. Consider the employees at Salesforce, one of the most socially active companies in the world. In March of 2016, Salesforce threatened to pull its employees out of Indiana after former governor Mike Pence signed a law that permitted businesses to discriminate against those in the LGBTQ community. When asked about the company's stance, Salesforce CEO Marc Benioff remarked how it was his employees' decision; he was merely "advocating on their behalf."[165] Many employees of

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162. Kristie M. Young et al., *The Hidden Cost of Mergers and Acquisitions*, 19 MGMT. ACC. Q. 1 (2018).

163. *See id.* at 2–5.

164. *Id.* at 5.

165. Katy Steinmetz, *Salesforce CEO Marc Benioff: 'Anti-LGBT' Bills Are 'Anti-Business'*, TIME (Mar. 31, 2016), https://time.com/4276603/marc-benioff-salesforce-lgbt-rfra.

Salesforce have decided to commit their careers to Salesforce precisely because they are proud of this activism.

Courts should be hesitant to approve takeovers that will change the values and culture of the Target, especially when employees have a pivotal voice in the Target's activism. To determine the extent and importance of employees' social and activist expectations, courts should ask: *Does the Target have a culture that encourages employees to voice their concerns? Is the Target responsive to employee activism? What is the Bidder's culture and stance on activism and how will this affect employees' activism?*

3. *Creditors*

Creditors want to protect themselves from takeovers for two reasons. First, creditors fundamentally rely on managing risk and takeovers are inherently risky. Second, creditors want to save themselves from risk-seeking directors, who are not always incentivized to act in creditors' best interests.[166]

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166. Mark Van Der Weide, now the general counsel of the Federal Reserve, discussed this at length in an article he wrote while he was an associate at Cleary, Gottlieb, Steen & Hamilton in 1992:

> As an illustration, suppose corporation Hercules has $1 million of debt in its capital structure and faces two investment possibilities: Project Alpha, providing a fifty percent probability of a $2 million return and a fifty percent probability of a $1 million return; and Project Beta, providing a fifty percent probability of a $3 million return and a fifty percent probability of a $500,000 return. While bondholders would prefer that their debtor pursue Project Alpha, because Alpha guarantees repayment of the debt, shareholders would prefer Project Beta, because Beta maximizes the expected value of shareholder gains. Because the shareholders control the corporation, the corporation will likely pursue Project Beta.

Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 44 (1996). A real-world application of this phenomenon took place in 1999, when Deutsche Bank acquired Bankers Trust. Bankers Trust was a financial institution that was facing an accounting scandal. It specialized in highly risky derivative investments. Deutsche Bank was willing to take a substantial business risk by acquiring Bankers Trust because it saw an opportunity to become one of the biggest banks in the world. The deal had a low probability of success and surely would not have been approved by those with deposit accounts in Deutsche Bank (we can think of these as the bank's creditors). Deutsche Bank wrote off billions of dollars of goodwill associated with this acquisition just five years later. Now, Deutsche Bank is arguably a going concern and the bank's deposit holders are deservedly frustrated. *See* Aaron Elstein, *Deutsche Bank's Problems Trace Back to Long-ago Bankers Trust Merger*, CRAIN'S (May 31, 2018), https://www.crainsnewyork.

Courts generally do not have to protect the expectations of long-term creditors, including commercial banks and bondholders. These creditors have the knowledge and means to contract around M&A activity because they are institutionalized. Accordingly, long-term creditors often protect themselves by securing their debt, bargaining for higher interest rates, and contracting into poison put provisions, which allow creditors to redeem their investments "at face value (plus possibly some modest call premium)" if there is a takeover.[167]

However, courts need to protect the expectations of some creditors, like trade creditors. Trade creditors do not foresee takeovers being a problem because their relationship with the borrowing corporation is short-term and informal. In addition, the short-term debt market is highly competitive and trade creditors need to limit transaction costs as much as possible.[168] As a result, trade creditors do not usually contract around changes in control, and yet, short-term creditors still have important expectations concerning the company's solvency.

If short-term creditors are not in a position to contract around changes in control, courts should be hesitant to approve takeovers that materially increase the risk profile of the company. When a company is up for sale, courts should consider short-term creditors' reasonable expectations by asking: *To what extent does the Target borrow from short-term creditors? Will the Bidder satisfactorily remediate these short-term creditors? For instance, if the Bidder seeks to rollover the debt, to what extent will the Target's risk profile change if the Bidder acquires the Target?*

4. *Suppliers*

In most instances, suppliers can protect themselves from unfair takeovers by explicitly contracting with firms. Suppliers are incentivized to contract around takeovers with the companies they serve because suppliers rely on these companies being solvent and fulfilling their contractual obligations. Mean-

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com/article/20180531/FINANCE/180539972/deutsche-bank-s-problems-trace-back-to-long-ago-bankers-trust-merger.

167. *See* Coffee, Jr., *supra* note 45, at 1519 ("In brief, the poison put is a right given in the debt instrument to bondholders to demand repayment at their option of the full principal amount of the indebtedness (possibly plus a premium) in the event of certain occurrences such as a takeover, restructuring, recapitalization, or merger.").

168. *See* Tyler, *supra* note 116, at 412–13.

while, suppliers usually include, or have the capacity to include, change of control and anti-assignment provisions in their contracts with firms because suppliers are typically institutionalized. As a result, suppliers' expectations generally do not need to be protected by courts.

However, suppliers that make firm-specific investments to fulfill supply contracts cannot adequately protect themselves from takeovers. For instance, some suppliers make goods that are unique to a company and cannot be resold to anyone else. Other suppliers build factories specifically to fulfill contracts that require a lot of output. A supplier that enters into this type of arrangement can be taken advantage of by an opportunistic firm after the supply contract commences because, at this point, an opportunistic firm can use its bargaining power to contract out of a change of control provision or otherwise get better contractual terms. In addition, it is difficult for these suppliers to foresee, and successfully bargain for, contractual provisions that will adequately remediate them if the opportunistic firm breaches.

Walmart infamously exploits suppliers that make firm-specific investments. For example, in the 1990s, Walmart used Lovable, a lingerie company, as a supplier. After the parties entered into a contract and Lovable had already invested considerably into the relationship, Walmart found an opportunity to purchase cheaper lingerie. Walmart demanded that Lovable bring down its prices to match those promised by the new suppliers. When Lovable informed Walmart it could not do so and remain profitable, Walmart strategically reneged its supply contract with Lovable. Lovable had to close the factories they built specifically to fulfill their Walmart contracts. Consequently, three years after Walmart reneged the contract, Lovable went out of business.[169]

Courts should be hesitant to approve takeovers that detriment suppliers that make firm-specific investments. Courts should consider the expectations of these suppliers by asking: *To what extent does the Target contract with suppliers that have invested in firm-specific assets? Will these suppliers' contracts survive the*

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169. *See* Charles Fishman, *The Wal-Mart You Don't Know*, FAST COMPANY (Dec. 1, 2003), https://www.fastcompany.com/47593/wal-mart-you-dont-know.

takeover? Are these suppliers sufficiently protected by their explicit contracts, or does the takeover unfairly detriment them?

5. *Customers*

Courts that adopt the reasonable expectations framework generally do not have to consider the expectations of consumers in the M&A context for two reasons. First, like other stakeholders discussed above, consumers are often institutionalized. Thus, many customers have the wherewithal to contract around takeovers. Second, and more importantly, the United States' antitrust regime, which has been regulating M&A for over a century, is designed precisely to deal with this issue and is better positioned to protect consumers' expectations than this framework.[170]

However, customers who rely on continuing their relationships with firms are not protected by the antitrust regime.[171] Some customers—like those that buy durable goods—expect to have ongoing relationships with suppliers.[172] For instance, when a customer purchases a kitchen appliance that has a warranty, the customer expects that the warranty will be honored if the appliance breaks. However, many companies that engage in M&A activity are disincentivized or simply unable to provide quality, ongoing services with respect

170. However, M&A activity often decreases competition, allowing firms to raise prices and lower the quality of their goods without consequences. Thus, it is doubtful whether the antitrust regime works as intended. Indeed, customers do not expect that takeovers will require them to pay more for lower quality goods, and yet, they often must pay the price of monopolism:

> A recent meta-analysis of post-merger studies confirms that antitrust regulators in the United States have routinely allowed M&A activity that increases prices. Thirty-four of the forty-two mergers studied (81%) resulted in "often substantial" price increases, while only eight showed price decreases. The meta-analysis also found negative effects to product and service quality post-merger as well as other negative anti-competitive effects. These studies illustrate that post-merger, consumers must pay higher prices, settle for lesser goods, or both.

Griffin, *supra* note 147, at 106–07.

171. *See* Daniels, *supra* note 33, at 321–22.

172. Durable goods yield utility over a long period of time. They are not purchased frequently and often require maintenance at some point in the good's life span. Examples of durable goods include cars, jewelry, and home appliances.

to durable goods. This is an agency dilemma that is analogous to the final period problem discussed in Section III.A.

Customers similarly rely on continuing relationships with companies that offer loyalty rewards, as exemplified by Marriott's acquisition of Starwood.[173] Before Starwood was acquired by Marriott, Starwood had a popular loyalty program with millions of hotel customers. Many of these customers stayed at Starwood hotels precisely because they expected their loyalty with Starwood to pay off in the long-run. In the end, Marriott decided to allow Starwood customers to convert their Starwood points to Marriott points.[174] However, if Marriott had chosen to disregard Starwood's rewards program, customers of Starwood would have been unfairly disadvantaged by the takeover.

Courts should be skeptical of takeovers that do not adequately address consumers' post-purchase expectations. Courts should assess how a takeover will affect customers who rely on their ongoing relationships with firms by asking: *Do a significant portion of the Target's customers rely on an ongoing relationship with the Target? Does the Bidder address if and how it will handle these relationships? Will these customers be disadvantaged by the takeover?*

6. *Community and Environment*

Even communities form implied contracts with the corporation. Communities provide contractual consideration by contributing "investments in infrastructure – schools, roads, sewers and other public utilities, not to mention tax relief – in consideration for getting a major corporate facility to locate or remain within its boundaries."[175] Meanwhile, corporations provide consideration by contributing capital to communities in various forms. They pay taxes directly to the community and may contract with local suppliers that pay taxes to the community. Corporations also hire local employees who pay income

173. Simon Cooper & Vipula Gandhi, *How to Retain Customers During M&A*, GALLUP (Apr. 2018), https://www.gallup.com/workplace/236120/retain-customers-during.aspx.

174. Brian Kelly, *Marriott and SPG Announce Details of Their New Unified Loyalty Program*, THE POINTS GUY (Apr. 16, 2018), https://thepointsguy.com/news/details-unified-marriott-spg-loyalty-program.

175. Van Der Weide, *supra* note 166, at 53–54.

taxes. Indeed, corporations and communities have an uncommon, yet essential, ongoing contractual relationship.

Courts must protect communities' expectations in this contractual relationship because communities are particularly vulnerable to unexpected moves and plant closings.[176] If the corporation moves its operations, the community's investments in the corporation are for naught: "[a]ll the road, water, and sewer improvements built to serve the plant will become worthless, schools will become vacant as workers leave, and the value of homes built in anticipation of continued employment will decline."[177]

While communities can explicitly contract with corporations around takeovers and plant closings, it is difficult for communities to protect their interests in the long-run because they have no bargaining power.[178] Corporations can threaten to leave the community, hoping to get tax breaks and other concessions. Communities are pressured to oblige because they are desperate for the company to stay and do not want their capital contributions to go to waste.

Courts should scrutinize takeovers in which corporations will abandon the communities they serve, especially when these communities have not burdened the Target with more taxes or regulations. When a company is for sale, courts should consider the expectations of communities by asking: *Will the Bidder move the Target out of a community? If so, when will this move happen? How long has the corporation been in the community and has the community seen a return on its investment? Is the community's*

176. Of course, employees are also particularly vulnerable to plant closings. *See* O'Connor, *supra* note 154, at 1196–203.

177. William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385, 415 (1990).

178. To illustrate how difficult it is for communities to achieve long-run success by contracting with corporations, consider Amazon's recent search for a second headquarters. Amazon had immense bargaining power, soliciting over 200 bids, each offering millions of dollars in tax breaks. Amazon ultimately chose Arlington, Virginia, which will enable the company to receive approximately $1 billion in tax breaks. In turn, Amazon must open up 25,000 jobs in the area and occupy 6,000,000 square feet of office space by 2034. But what happens after that? *See* Monica Nickelsburg, *Full Details of Amazon's HQ2 Deal with Arlington County, Va., Revealed for the First Time*, GEEKWIRE (Mar. 5, 2019), https://www.geekwire.com/2019/amazons-hq2-deal-with-arlington-county-gives-big-concessions-asks-little-of-the-company.

action (e.g., increasing taxes or regulations) or inaction (e.g., ignoring problems with infrastructure) prompting Bidder's anticipated move?

Courts should also consider whether a takeover will increase the Target's environmental footprint. The environment is a particularly complicated stakeholder for two reasons. First, environmental harms do not easily translate into economic injury. For example, it is generally impossible to determine whether a particular corporation's contribution to air contamination caused an individual's medical problem. Second, protecting the environment in this context brings about a problem with standing and enforcement. Who has the standing to sue a company for harming the environment? Who is willing to incur the costs of litigation? This is precisely why courts have to protect the environmental expectations of communities and greater society when a company is up for sale.[179] Indeed, courts should be skeptical of takeovers that materially and adversely affect the Target's environmental footprint.[180]

D. *What Are the Drawbacks of Using the Reasonable Expectations Approach?*

One particularly convincing drawback of the reasonable expectations approach is that balancing stakeholders' interests is difficult to administrate. Indeed, the reasonable expecta-

179. This Note's discussion of the environment as a stakeholder is limited. Several academics have proposed more sophisticated and protective frameworks to ensure the environment is not ignored as a stakeholder. For instance, Cynthia Williams suggests that boards should have a duty of loyalty to the environment "to ensure companies have a functioning information and reporting system geared to good faith law compliance by employees of the company." Cynthia A. Williams, *Fiduciary Obligations to Consider when Considering Climate Change* 11 (unpublished manuscript) (on file with author). Williams thinks we can underlie this duty of loyalty with human rights claims, securities law claims, and fraudulent misrepresentation claims. *Id.* at 14–16. Meanwhile, an academic in England suggests that we ought to create a private body with disciplinary powers that "agree [to] environmental targets with the regulated company's directors on an annual basis, and monitor compliance with those targets, sanctioning a company for unwarranted failure." Nick Grant, *Mandating Corporate Environmental Responsibility by Creating a New Directors' Duty*, 17 ENVTL. L. REV. 252, 262 (2015).

180. Luckily, in modern society, M&A activity is usually environmentally-friendly. Pfizer's $68 billion acquisition of Wyeth in 2009 exemplifies how corporations use takeovers to improve their environmental outlook. *See* Scott Moeller & Zhenyi Huang, *Green Business: The Environmental Impact of M&A*, CASS BUS. SCH. 15–16 (June 2019).

tions approach requires that courts assess the expectations of all relevant parties, including the board. In addition, similarly-situated stakeholders often have different expectations. This is particularly true for employees

To show why this can be complicating, consider a company that is up for sale and has two bidders: Bidder A promises to lay off no employees and Bidder B will lay off some employees. However, Bidder B will give substantial raises to those who are not laid off. Of course, some employees will favor Bidder A, while other employees will favor Bidder B. The employees that favor Bidder A will assert that employees generally do not expect their jobs to end because of M&A activity. The employees that favor Bidder B will assert that companies lay off employees all the time and that good employees expect pay raises as a result of their hard work. This discrepancy undoubtedly presents an administrative challenge with regards to balancing expectations and determining the authenticity of expectations.

This Note anticipates three additional criticisms of the reasonable expectations approach, all of which are unconvincing. One such criticism is that this approach will hinder economic progress because it disincentivizes boards from seeking takeovers. This criticism assumes that all M&A is good. However, many takeover transactions leave stakeholders by the wayside. When firms merge, employees can be worse off "since the firm faces less pressure from competitors to raise wages or provide better working conditions for its employees."[181] In addition, consumers can be worse off because an increase in market power allows firms to increase prices while decreasing the quality of goods.[182] Lastly, communities can be worse off because M&A can contribute to economic inequality; typically-wealthy shareholders benefit while other stakeholders bear the hidden costs of M&A.[183] Indeed, the reasonable expectations approach should only hinder takeover activity that is certain to harm stakeholders.

A second unconvincing criticism of the reasonable expectations approach is that courts should not interpret business decisions. This argument is unfounded when directors are es-

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181. Griffin, *supra* note 147, at 92.
182. *Id.* at 108–09.
183. *Id.*

pecially tempted to shirk or act in their own self-interest. A recent empirical study concludes that takeover jurisprudence is only as good as the courts that monitor the substance of corporate transactions.[184] As Stephen Bainbridge eloquently asserts: "Judges are not doctors, but they routinely review medical decisions. Judges are not engineers, but this does not preclude design defect litigation. . . . [C]ourts can, and do, substantively review board decisions in contexts, like this one, in which the conflict of interest is so pronounced."[185]

A third and final unconvincing criticism of the reasonable expectations approach is that it makes the board less efficient. Well, of course it does. Corporate governance, at its core, is a tension of accountability and authority.[186] When boards need to be held more accountable, like when a company is up for sale, the board will have less authority, making the decision-making process less efficient. This is a contemplated tradeoff that this Note has already established is necessary.[187]

Conclusion

In the M&A context, constituency statutes have not adequately protected stakeholders, particularly those at corporations that are up for sale. In part, the statutes are to blame. This Note suggests that two changes should be made to constituency statutes. First, constituency statutes should give stakeholders the standing to sue the board or provide some other enforcement mechanism. Second, constituency statutes should either require companies to opt in or opt out of the statute, or alternatively, mandate that companies consider stakeholders' interests.

Courts are also to blame for not protecting stakeholders in M&A. Courts in states with constituency statutes typically rely on the business judgment rule when a company is up for sale. However, the business judgment rule cannot adequately protect stakeholders in this context because directors are in their final period with the firm. Directors who are in their final period with the firm generally do not face repercussions for

184. Dain et al., *supra* note 95.
185. Bainbridge, *supra* note 9, at 1021.
186. Bainbridge, *supra* note 83, at 818–28; *see also* Bainbridge, *supra* note 28.
187. *See supra* Section III.A.

their culminating actions with the firm and, as a result, are tempted to act selfishly. This was contemplated by *Revlon* and its progeny and is precisely the reason why Delaware courts do not use the business judgment rule when a company is up for sale. Unfortunately, Delaware's solution–choosing the highest bid–is incompatible with stakeholder theory and cannot guide courts in states with constituency statutes.

This Note proposes a necessary alternative to the business judgment rule that courts should use to protect stakeholders and their expectations in certain M&A contexts, like when a company is up for sale. To arrive at this framework, we must think of the corporation as a nexus of contracts and deduce that the nexus of contracts theory is not exclusively compatible with shareholder primacy. Indeed, this Note debunked the theory that shareholder primacy is a contractual default rule by establishing that:

(1) non-shareholders have variable claims in the corporation;
(2) non-shareholders are not uniquely positioned to contract around the default rule; and
(3) shareholder primacy is not a default rule in any traditional sense because non-shareholders never have bargained around the default rule and they probably never will.

Relying on these precepts, this Note's proposed reform advises that courts look at the contractual relationships between stakeholders and corporations. Since stakeholders and corporations enter into relational contracts that are mostly incomplete, courts can and should gap-fill by inquiring into these parties' post-investment reasonable expectations. Courts ought to closely consider the expectations of employees, short-term creditors, suppliers that make firm-specific investments, customers that rely on continuing their relationships with firms, and communities when assessing an impending takeover because these stakeholders are unable to adequately protect themselves by explicitly contracting with firms. While it may be challenging for courts and directors to balance stakeholders' expectations, this balancing act is clearly necessary to make stakeholder theory viable in M&A.