

Corporate Law and Governance Pluralism

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Abstract

For the past several decades, jurists have invested significant efforts in developing the law in general—and private law in particular—in terms of pluralism. However, the conceptualization of corporate law and governance according to pluralist principles rarely exists. This Essay is the first in the legal literature to address this deficiency by providing a unique pluralist theory of corporate governance regimes. It distinguishes between the plurality of corporate law’s sources, values, and principles, and discusses the implications for governance. Moreover, based on the social systems’ thinking and the framework of complexity, this Essay provides theoretical grounds for skepticism about any policies or structures applicable to all times and contexts. Therefore, rather than perceiving corporate governance as being identically applicable to all corporations, the law must meet the challenge of complexity by designing governance arrangements following a firm-specific perspective. Furthermore, I argue that in conditions of complexity, corporate governance eco-systems should be designed with a firm-specific view that incorporates the effect of the corporation participants’ heterogeneity, the heterogeneity of its internal power relations, and the heterogeneity of industries and markets. These novel arguments have profound implications for redesigning fundamental legal doctrines—such as fiduciary duties of controlling shareholders, regulation of related party transactions, the officers’ duty of care, and the company purpose.

Introduction

Over the past several decades, courts and scholars in the United States and Europe have invested significant efforts in developing law in general—and private law, in particular—in line with a pluralistic view.¹ For example, pluralist conceptions of contract law are based on the notion that a single theoretical principle,² such as promise or efficiency, cannot encompass the entire realm of contract doctrines, or different contractual transactions between various parties. Similarly, while traditional theories of property rights conceived the notion of

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1. See Steven J Burton, “Normative Legal Theories: The Case for Pluralism and Balancing” (2013) 98:2 Iowa L Rev 535 at 537 (“[r]obust pluralist theories take all relevant values into account and balance them when they compete”).
 2. See Charles Fried, “The Ambitions of *Contract as Promise*” in Gregory Klass, George Letsas & Prince Saprai, eds, *Philosophical Foundations of Contract Law* (Oxford University Press, 2014) 17; Gregory Klass, “Efficient Breach” in Klass, Letsas & Saprai, *ibid* at ch 18.

property on the basis of natural rights or utilitarian consequentialism,³ today it is agreed that dimensional ‘monist’ theories cannot fully explain the value and limits of property law.⁴ A comparable approach has been adopted in the study of tort law. For example, Izhak England has introduced the concept of *complementarity*—which reduces the conflict between corrective justice and distributive justice perspectives of tort law by seeking to harmonize those goals.⁵ In light of all this, the lack of a comprehensive pluralist theory of corporate law seems puzzling, given that pluralist foundations of private law may, *mutatis mutandis*, also apply to the design of corporate governance regimes. To fill this gap, we call for designing the common law of corporations based on tailoring governance and control arrangements to firm-specific power relations resulting from agency conflicts and the unique aspects of the markets.

Generally, shareholders are perceived as the residual owners of the company who are entitled to receive the remaining returns after the company repays its obligations to its stakeholders.⁶ However, as agency theory explains, the control over the company’s decision-making is in the hands of self-interested insiders who do not necessarily act to increase shareholders’ value.⁷ For example, in companies with a concentrated ownership structure, blockholders have control over the firm’s business activities and can run them against the interests of minority shareholders.⁸ As a result, corporate governance includes various mechanisms—such as board composition, executive pay, the market for corporate control, and gatekeepers—for redressing the costs resulting from agency relationships.⁹

Nevertheless, the legal literature tends to capture the agency relationship between shareholders and management or controlling and minority shareholders in a unified fashion which does not consider the variation of power relations under the agency framework. The agency theory generally describes the consequences of insiders’ and outsiders’ interactions in the corporations’

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3. See Emily Sherwin, “Locke and Private Law” in Hanoch Dagan & Benjamin C Zipursky, eds, *Research Handbook on Private Law Theory* (Edward Elgar, 2020) 174; Gregory S Alexander & Hanoch Dagan, *Properties of Property* (Wolters Kluwer, 2012) at ch 3.
 4. See Hanoch Dagan, *Property: Values and Institutions* (Oxford University Press, 2011) at 42; Gregory S Alexander, “Property, Dignity, and Human Flourishing” (2019) 104:4 *Cornell L Rev* 991 (proposing that property should be analyzed under a ‘pluralist’ framework envisioned to promote human flourishing).
 5. See Izhak England, *The Philosophy of Tort Law* (Dartmouth Publishing Company, 1993) at 85-92. See also Benjamin Shmueli, “Legal Pluralism in Tort Law Theory: Balancing Instrumental Theories and Corrective Justice” (2015) 48:3 *U Mich JL Ref* 745 at 746-50.
 6. See Reinier Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 3d ed (Oxford University Press, 2017) at 13-14.
 7. See Michael C Jensen & William H Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976) 3:4 *Journal of Financial Economics* 305 at 310.
 8. See Lucian A Bebchuk & Assaf Hamdani, “The Elusive Quest for Global Governance Standards” (2009) 157:5 *U Pa L Rev* 1263 at 1281-85.
 9. See e.g. Ruth V Aguilera & Gregory Jackson, “Comparative and International Corporate Governance” (2010) 4:1 *The Academy of Management Annals* 485.

field. However, it does not analyze the implications of differences in the power interplays between them as part of the agency relationship itself.

To design tailored corporate governance regimes as an expression of corporate laws' diverse value, we employ the social systems theory¹⁰ and the framework of complexity which were developed by sociology scholars.¹¹ Sociological research maintains that organizations are a subset of social systems that exhibit considerable complexity in their form and features. They represent a sophisticated web of interconnectivity between human beings and their environment, by exhibiting non-linear behavior.¹² For the law to be able to predict and regulate a given behavior, it must examine the interactions between the constituent parts of the organization and its response to changes in their surroundings.¹³ In conditions of complexity, the role of corporate law is to conceptualize the varied effect of participants' heterogeneity and their interrelationships on outcomes and performance.¹⁴ These personalized corporate governance regimes would supplement the authority of the corporations' powerholders to independently design the mechanisms that guide their conduct as part of the private ordering approach.¹⁵

This Essay proceeds as follows. In Part I, I differentiate between two special forms of pluralism. *First*, the plurality of law's sources considers the coexistence of several systems and authoritative foundations—that some of them are not the product of the national state's law-making—for regulating private interactions. *Second*, the plurality of law's values, which reject the idea that ultimate principle can entirely explain or accommodate the richness of different doctrines in private or commercial law. In Part II, I lay the theoretical

10. Legal scholars have developed numerous implementations of complexity thinking to a broad range of legal doctrines in business organizations law. For one such complexity account of bankruptcy law, see Bernard Trujillo, "Patterns in a Complex System: An Empirical Study of Valuation in Business Bankruptcy Cases" (2005) 53:2 UCLA L Rev 357; Bernard Trujillo, "Self-Organizing Legal Systems: Precedent and Variation in Bankruptcy" (2004) 1:2 Utah L Rev 483. For a complexity account of business law, see Thomas Earl Geu, "Chaos, Complexity, and Coevolution: The Web of Law, Management Theory, and Law Related Services at the Millennium" (1998) 65:4 Tenn L Rev 925; Marc Goergen et al, *Corporate Governance and Complexity Theory* (Edward Elgar, 2010) at 81. For a general overview, see JB Ruhl & Daniel Martin Katz, "Measuring, Monitoring and Managing Legal Complexity" (2015) 101:1 Iowa L Rev 191 (proposing methods for monitoring legal complexity over time—particularly by conceptualizing Legal Maps, a multi-layered, active representation of the legal system network at work).

11. For extended analysis, see section II.A.

12. See Jamie Murray, Thomas E Webb & Steven Wheatley, "Encountering Law's Complexity" in Jamie Murray, Thomas E Webb & Steven Wheatley, eds, *Complexity Theory and Law: Mapping an Emergent Jurisprudence* (Routledge, 2018) 3 at 8-9.

13. See Thomas E Webb, "Tracing an Outline of Legal Complexity" (2014) 27:4 Ratio Juris 477 (linking complexity science principles to legal systems from the views of inside the system, the boundary with the external environment, the external environment, and the coevolving system of the systems as a whole); Lynn M LoPucki, "The Systems Approach to Law" (1997) 82:3 Cornell L Rev 479 at 497-509 (presenting system methodology developed in the fields of engineering, business information systems, and computer programming, to manage complexity).

14. See section II.B.

15. See Frank H Easterbrook & Daniel R Fischel, "The Corporate Contract" (1989) 89:7 Colum L Rev 1416 at 1444-45 ("[c]orporate codes and existing judicial decisions supply these terms 'for free' to every corporation, enabling the ventures to concentrate on matters that are specific to their undertaking").

foundations for the plurality of corporate law's values that stems from the complexity framework, and its application for studying societies and organizations. I argue that business organizations should be considered as complex adaptive systems that include constant interactions between different governance devices. To overcome the complexity involved in such interactions, courts should design internal and external corporate governance arrangements following a firm-specific view. In Part III and Part IV, I provide a legal map of the corporate governance ecosystem, by exploring the legal implications of our view for redesigning internal and external governance devices. In Part III, I discuss several governance arrangements for regulating the internal relationship between controlling and minority shareholders—such as the fiduciary duties of controlling shareholders, the regulation of related party transactions, and the officers' duty of care. In Part IV, I analyze external governance arrangements that regulate the relationship of the company as a separate and distinct legal entity with a wide range of stakeholders and focus on the company's goal debate. In Part V, I consider several challenges associated with implementing a firm-specific view in corporate law. I will then summarize my conclusions.

I. The Idea of Pluralism in Corporate Law

A. Pluralism in Law: A (Short) Introduction to the Literature

The traditional concept of pluralism in law was developed by legal anthropologists and sociologists who analyzed overlapping normative orders within societies that challenge the exclusive authority of the state in making and administering law.¹⁶ It was initially related to a colonial context in which European countries placed their own legal systems on top of the indigenous system and traditions.¹⁷ It captures the descriptive idea that in any conventional geographical boundaries of a state, there is more than one legal system. Thus, state law is not the only normative source for regulation and governance, as there are non-state systems of law that also apply for regulating the conduct of a population, community, or individual.¹⁸ The existence of multiple and diverse systems of law that apply to a certain factual situation generates uncertainty because it involves “competing claims of authority [that] impose conflicting demands or norms . . . [and] may have different styles and orientations.”¹⁹ As a result, individuals and societal groups cannot

16. See Brian Z Tamanaha, “Understanding Legal Pluralism: Past to Present, Local to Global” (2008) 30:3 Sydney L Rev 375 at 375-76.

17. For overview of the literature, see e.g. Margaret Davies, “Legal Pluralism” in Peter Cane & Herbert M Kritzer, eds, *The Oxford Handbook of Empirical Legal Research* (Oxford University Press, 2010) 805.

18. *Ibid* at 805-06.

19. Tamanaha, *supra* note 16 at 375.

anticipate which legal regime will be applied to their conduct and lack the ability to determine the consequences of their actions in advance.

The plurality of normative orders opposes the monistic concept that regards the law as an exclusive product of the sovereign states' actions. Pluralist scholars are motivated by the ambition to increase pluralism in the regulatory state by delegating policymaking responsibilities to private parties.²⁰ They consider the monistic concept to be hypothetical, and that it does not correspond to the pluralist reality of legal norms. As John Griffiths put it, "[I]legal pluralism is the fact. Legal centralism is a myth, an ideal, a claim, an illusion."²¹ Thus, scholars employ the distinction between 'law as one' and 'law as many' to capture the idea that law can only be understood as "a combination of conceptions rather than in a single conception, and in a range of linguistic forms rather than in any single form."²² Accordingly, pluralist theories acknowledge that there are overlapping state and non-state normative orders that are produced by a variety of actors to regulate commerce, trade, and finance.²³

Furthermore, this understanding of pluralism focuses on the interactions of the national legal orders with international normative arrangements, "whether these stem from 'official' sources or from unofficial sources such as transnational corporations, NGOs, [and] 'private' regulatory codes."²⁴ These exchanges are the result of the globalization process that involves the removal of geographical and cultural distances between different societies, thereby challenging the local and national references of law. Accordingly, pluralism of law is related to exploring the relationship between 'law' and 'space' which postulates neither of them can exist without the other.²⁵ Therefore, any state's support for monopoly over the creation and application of law within its geographical boundaries cannot be sustained.

While many scholars concentrated on the multiple systems of normative orders that co-exist in the private and public sphere, other scholars have explored the role of pluralism as part of articulating theoretical justifications for the normative orders themselves. For example, while monist theories of private or commercial law perceive normative institutions as a mechanism for accomplishing single or ultimate value or virtue, pluralist conceptions are grounded on the idea

20. See David M Lawrence, "Private Exercise of Governmental Power" (1986) 61:4 Ind LJ 647 at 652: "[a] variety of claims have been made for the benefits accruing to society from the existence and continuation of private power centers that are apart from and sometimes in competition with government. . . . And other defenders of pluralism have argued that it enhances individual opportunity for growth, self-expression, development of intimate contacts with others, and moral responsibility."

21. John Griffiths, "What is Legal Pluralism?" (1986) 24:1 J Leg Pluralism & Unofficial L 1 at 4.

22. Richard Nobles & David Schiff, "Using Systems Theory to Study Legal Pluralism: What Could Be Gained?" (2012) 46:2 Law & Soc'y Rev 265 at 266.

23. See John Linarelli, "Global Legal Pluralism and Commercial Law" in Paul Schiff Berman, ed, *The Oxford Handbook on Global Legal Pluralism* (Oxford University Press, 2020) 689 at 689.

24. Davies, *supra* note 17 at 808.

25. See Franz von Benda-Beckmann, Keebet von Benda-Beckmann & Anne Griffiths, "Space and Legal Pluralism: An Introduction" in Franz von Benda-Beckmann, Keebet von Benda-Beckmann & Anne Griffiths, eds, *Spatializing Law: An Anthropological Geography of Law in Society* (Routledge, 2016) 1.

that a single principle cannot capture the richness of doctrines as applied to different parties, transactions, markets, and industries.²⁶

Because various principles provide valuable insights for comprehending the function of different legal doctrines, private law cannot be confined to a single overreaching theory or principle.²⁷ Diverse types of doctrines incorporate a different set of values derived from broad social theories and the exact balance between them indicates how legal institutions operate practically. Thus, private law generally encompasses values, principles, and concepts derived from law and economics, philosophy, sociology, and the behavioral sciences, and the special balance between these perspectives is accomplished through their application to “markets, risks, persons and organizations.”²⁸ By designing narrow rules that address specific actual interactions, doctrines’ theoretical justifications will be closely aligned with the specific factual characteristics. Put differently, by focusing on the importance of context, pluralist justifications could capture more accurately the diverse public policy issues involved in different private law doctrines.

To illustrate the last point, let us see how pluralism of values can be expressed in the specific branch of private law that is contract law. Pluralist interpretations of contract may be understood in at least three different forms. According to one view, right-based and efficiency-based perspectives best fit and justify contracting practices of different parties, such as ordinary individuals and business organizations. For example, Ethan Leib argued that types of contracts have a significant relevance for building a general theory of contracts. He demonstrated that the applicability of autonomy theories should be limited to contracts between individuals, and implantation of efficiency theories should be limited to contracts between business firms.²⁹

A second view posits that different theories of contract can explain and justify various kinds of transactions. Karl Llewellyn was among the first scholars to acknowledge the significance of context in interpretation and application of contract rules in specific settings, and urged for constructing specific rules for different types of transactions, such as sale, lease, or license, as well as between different types of contractors, such as merchant, consumer, minor, or arms-length parties.³⁰

26. See Hanoch Dagan, “Pluralism and Perfectionism in Private Law” (2012) 112:6 *Colum L Rev* 1409 at 1409: “[this] calls for a pluralist turn in private law theory and argues that a structurally pluralist and moderately perfectionist understanding provides a better account of private law generally.”

27. See Efi Zemach & Omri Ben-Zvi, “Contract Theory and the Limits of Reason” (2017) 52:2 *Tulsa Law Review* 167 at 206.

28. Stefan Grundmann, Hans-W Micklitz & Moritz Renner, *New Private Law Theory: A Pluralist Approach* (Cambridge University Press, 2021) at 35.

29. See Ethan J Leib, “On Collaboration, Organizations, and Conciliation in the General Theory of Contract” (2005) 24:1 *Quinnipiac L Rev* 1; Alan Schwartz & Robert E Scott, “Contract Theory and the Limits of Contract Law” (2003) 113:3 *Yale LJ* 541 (advocating a distinction between mercantile contracts and others by suggesting that for contract between business firms, ‘formalist’ or ‘textualist’ interpretation should be adopted as the default rule).

30. See Karl N Llewellyn, *The Common Law Tradition: Deciding Appeals* (Little, Brown & Company, 1960) at 20; Larry A DiMatteo & Blake D Morant, “Contract in Context and Contract as Context” (2010) 45:3 *Wake Forest L Rev* 549 at 564.

More recently, Dagan and Heller articulated a novel pluralist theory that includes diverse types of contracts which entail different contract institutions for various social settings and commercial purposes.³¹ Drawing on the work of Joseph Raz, they argue that extending autonomy should be the law's primary concern, which requires the law to increase the range of contractual choices available.³² Each contract institution—such as business transactions, consumer transactions, employment contracts, or family contracts—includes a distinct balance of values and thus should be governed by a separate regulative principle fit to its subject matter. Such a rich collection will enable people to freely choose their ends, principles, forms of life, and association.³³

A third view provides that different parts and doctrines of contract law are best described and justified by multiple contract theories. As explained by Eyal Zamir,

[N]otions such as respect for private will, maximization of aggregate social welfare, rectification of reliance losses and undoing of unjust enrichment, redistribution of power and wealth, fairness and equivalence of exchange, and paternalism—to name but some of the key concepts in a pluralistic contract law theory—are applicable to any modern, western system of contract law. Even if their significance and implications vary from one type of transaction to another and by different legal system, they are potentially relevant to any transaction in a great variety of systems.³⁴

Similarly, Prince Saprai argued, recently, that the shape, structure, and content of contract law in any particular jurisdiction should embrace a contingent attitude. Thus, instead of relying on 'top-down' deontic or consequentialist theory, which provides one correct answer to the entire realm of contract law, jurists should pay closer attention to the plurality of conflicting values embodied in each of the doctrines.³⁵

We discussed two primary forms of pluralism in law: numerous sources of law which are not restricted to national states' geographical borders; and the richness of the theoretical justifications embodied in different private law doctrines. I argue below that the contractual perspective of corporate law and the strategies of private ordering correspond to the first perception of pluralism in law, namely the multiplicity of legitimate sources of law.

31. See Hanoch Dagan & Michael Heller, *The Choice Theory of Contracts* (Cambridge University Press, 2017).

32. See *ibid* at 68: “[W]e develop two points from Raz’s political philosophy with particular usefulness for contract theory: (1) to be free, individuals need meaningful choice and (2) states have a necessary role in supporting the availability of valuable options.”

33. See Hanoch Dagan, “Autonomy, Pluralism, and Contract Law Theory” (2013) 76:2 *Law & Contemp Probs* 19 at 33.

34. Eyal Zamir, “Contract Law and Theory: Three Views of the Cathedral” (2014) 81:4 *U Chicago L Rev* 2077 at 2086-87.

35. See Prince Saprai, *Contract Law Without Foundations: Toward a Republican Theory of Contract Law* (Oxford University Press, 2019) at 1-4.

B. Private Ordering and the Plurality of Corporate Law's Sources

Corporate law is regarded as a set of default terms that incorporators would have adopted if they could consider all possible eventualities and if transaction costs had not been prohibitive.³⁶ It is perceived to reduce the costs of bargaining and incorporation by providing rules that are generally efficient and are in the interest of the incorporators.³⁷ In particular, parties do not have to anticipate all eventualities that may arise in their relationship, because the default rules provide a nexus of contractual provisions that are available when eventualities materialize.³⁸ Accordingly, corporate law has an enabling function that minimizes the number of mandatory provisions, offers an optimal set of default rules, and enforces parties' arrangements adopted in charters and bylaws.³⁹ Thus, various legal systems allow corporators to design governance mechanisms that differ from the standardized default rules provided by corporate statutes.⁴⁰ These statutes establish off-the-rack corporate rules that provide the freedom to opt-out (or in) by adopting tailored governance alternatives.⁴¹ For instance, the board and shareholders can approve a special amendment to the corporation's charter, such as adopting or

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36. See Carsten Gerner-Beuerle & Michael Schillig, *Comparative Company Law* (Oxford University Press, 2019) at 252-53: "In all of these cases, market incentives could be expected to give rise to more finely nuanced governance structures that were responsive to the particular situation of the company and the preferences of investors. Thus, this view of corporate governance is characterized by the primacy of private ordering. Legal rules, if they exist at all, should be formulated as default rules, similar to standard form contracts that are made available by the policy-maker to reduce the cost of contracting."
37. See Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1996) at 34-35.
38. See James D Cox, "Corporate Law and the Limits of Private Ordering" (2015) 93:2 *Washington University Law Review* 257 at 261: "the default rule is tailored toward what the legislature believes most, but not all, of an organization's stakeholders would have agreed to if contracting were efficient."
39. See Albert H Choi & Geeyoung Min, "Amending Corporate Charters and Bylaws" (18 October 2017) at 1, online (pdf): *Legal Scholarship Repository* https://scholarship.law.upenn.edu/faculty_scholarship/1898.
40. See D Gordon Smith, Matthew Wright & Marcus Kai Hintze, "Private Ordering with Shareholder Bylaws" (2011) 80:1 *Fordham L Rev* 125 at 139 (arguing that "corporate bylaws serve as a contracting platform for shareholders, providing a logical, accessible channel for private ordering in public corporations"); Jill E Fisch, "The New Governance and the Challenge of Litigation Bylaws" (2016) 81:4 *Brook L Rev* 1637 (arguing that in the 'new governance' of corporate law issuer boards have limited the exercise of shareholder power—both procedurally and substantively—by adopting structural provisions in the corporate charter or bylaws); Jill E Fisch, "Governance by Contract: The Implications for Corporate Bylaws" (2018) 106:2 *Cal L Rev* 373 (challenging Delaware courts substantial deference to board-adopted bylaw provisions, even those that limit shareholder rights under the contractual approach).
41. See Robert Bartlett & Eric Talley, "Law and Corporate Governance" in Benjamin E Hermalin & Michael S Weisbach, eds, *The Handbook of the Economics of Corporate Governance: Volume 1* (North-Holland, 2017) 177 at 181-86; *Jones Apparel Group v Maxwell Shoe Co*, 883 A (2d) 837 (Del Ch 2004) at 845, stating "Delaware's corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations, subject to relatively loose statutory constraints and to the policing of director misconduct through equitable review"; *Hollinger Intern Inc v Black*, 844 A (2d) 1022 (Del Ch 2004) at 1078, stating "[t]he DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation. That capacious grant of power

abandoning cumulative voting, authorizing the board to amend the bylaws,⁴² or waiving liability for directorial negligence.⁴³ By implementing a private ordering approach to varying degrees—based on myriad factors, such as firm size, product-market maturity, and industry regulations—different firms may accumulate diverse benefits.⁴⁴ In the following discussion, I focus on two examples of private ordering in corporate law.

Business Opportunities Waivers

Generally, the corporate opportunities doctrine that is embodied in the fiduciary duty of loyalty does not allow directors and officers to appropriate business opportunities that belong to the company without first revealing it to the corporation and receiving its approval to pursue it directly.⁴⁵ The formulation of the doctrine in the United States is associated with the case of *Guth v. Loft*,⁴⁶ that was further developed in the case of *Broz v. Cellular Information Systems*.⁴⁷ Accordingly, courts have to engage in a fact-intensive inquiry to identify corporate business opportunity according to four main tests:⁴⁸ (1) the line of business test, (2) the business interest or expectancy test, (3) the fairness test, and (4) the Miller two-step test, which considers both the line of business test and fairness test for determining whether an officer is allowed to allocate a corporate business opportunity to himself.⁴⁹ However, parties can avoid litigation on the allocation of business opportunity by stipulating ex-ante a waiver in the corporate charter.⁵⁰

Ex-ante waivers are considered to be efficiently preferable because they create contractual well-defined rules that clarify the allocation of business opportunity and reduce the litigation costs involved in the complex fiduciary standards of the Anglo-American law.⁵¹ Following previous rulings that exemplified the difficulties of the undivided fiduciary model of corporate business opportunity and the benefit of allowing the company and its fiduciaries to design ex-ante contractual arrangements on the allocation of business opportunities,⁵² the Delaware

is policed in large part by the common law of equity, in the form of fiduciary duty principles”; *ATP Tour, Inc v Deutscher Tennis Bund*, 91 A (3d) 554 at 558 (Del 2014) [*ATP Tour*].

42. See 8 Del C § 109(a) (1953); Choi & Min, *supra* note 39 at 9-12.

43. See Bartlett & Talley, *supra* note 41 at 181-83.

44. See Jennifer G Hill, “The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering Combat” [2019] U Ill L Rev 507 at 524.

45. See Gabriel Rauterberg & Eric Talley, “Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers” (2017) 117:5 Colum L Rev 1075 at 1087.

46. 5 A (2d) 503 (Del 1939).

47. 673 A (2d) 148 (Del 1996).

48. See Rauterberg & Talley, *supra* note 45 at 1087.

49. See Martha M Effinger, “A New Corporate Statute: Adding Explicit Procedures to Maryland’s Corporate Opportunity Waiver Provision” (2019) 48:2 U Balt L Rev 293 at 297-300.

50. See Martin Gelter & Geneviève Helleringer, “Opportunity Makes a Thief: Corporate Opportunities as Legal Transplant and Convergence in Corporate Law” (2018) 15 Berkeley Business Law Journal 92 at 96.

51. *Ibid* at 117.

52. See *Siegmán v Tri-Star Pictures, Inc*, 1989 WL 48746 (Del Ch) [reprinted in (1990) 15:1 Del J Corp L 218]; Rauterberg & Talley, *supra* note 45 at 1090-95.

Assembly amended the state's statutes by adding subsection (17) to section 122 of the Delaware General Corporation Law. It permits a corporation to

[r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or one or more of its officers, directors or stockholders.⁵³

Limitations on Shareholder Litigation

Scholars and practitioners argue that the law has to acknowledge certain limitations on shareholder litigation against corporations (or their directors and officers). These lawsuits are often driven by lawyers' motivations to maximize chances of success despite the lack of a solid factual basis.⁵⁴ To overcome this difficulty, many companies in the United States adopted private ordering solutions in specific amendments to the charter and bylaws that place certain hurdles on shareholders' ability to initiate litigation. The most prevalent provisions in this regard are forum selection clauses that restrict future litigation to the courts of a particular jurisdiction and fee-shifting provisions that impose on the losing plaintiffs an obligation to pay defendants' attorneys' fees.⁵⁵ In 2015, the Delaware legislature authorized forum selection provision in the charter or bylaws and prohibited any provision relating to shifting defense costs to the plaintiff.⁵⁶ These

53. 8 Del C §(17) (1953). See also US, SB 363, *An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law*, 140th Gen Assem, Del, 2000, synopsis (enacted), online: <https://legis.delaware.gov/billdetail/10399> (“[t]he subsection is intended to eliminate uncertainty regarding the power of a corporation to renounce corporate opportunities in advance raised in *Siegman v Tri-Star Pictures, Inc.* It permits the corporation to determine in advance whether a specified business opportunity or class or category of business opportunities is a corporate opportunity of the corporation rather than to address such opportunities as they arise”); *Wayne County Employees' Retirement System v Corti*, 2009 WL 2219260 (Del Ch 2009) at 17 (“[i]t is conceded that 8 Del. C. § 122(17) permits a corporation to renounce in its certificate of incorporation any interest or expectancy in a corporate opportunity”). In principle, Canada does not allow the waiver of business opportunities by adopting a certain provision in the corporate charter. However, recently, the province of Alberta proposed amendments to its Business Corporations Act that “would make it easier for directors of private corporations to be involved with multiple related businesses and investments at the same time.” Ashley Joannou, “Alberta could become the first province in Canada to offer corporate opportunity waivers as part of new proposed amendment”, *Edmonton Journal* (15 November 2021), online: <https://bit.ly/3kOWw3J>.

54. See Ann M Lipton, “Limiting litigation through corporate governance documents” in Sean Griffith et al, eds, *Research Handbook on Representative Shareholder Litigation* (Edward Elgar, 2018) 176 at 176: “[t]he chief complaint is that such lawsuits are lawyer-driven—in the sense that attorneys identify the cases and control the litigation, aided by nominal plaintiffs with little real stake in the dispute—alleging misconduct based on nothing more than a stock price drop (or, more recently, the announcement of a merger.)”

55. See also Albert Choi, “Fee-Shifting and Shareholder Litigation” (2018) 104:1 Va L Rev 59 (arguing in favor of fee-shifting provisions in charters and bylaws and subjecting them to more robust judicial oversight).

56. See 8 Del C §102(f), §109(b), §115 (1953).

changes were made following rulings of Delaware courts that permitted bylaw provisions regarding a company's freedom to choose the forum in which shareholder litigation will take place,⁵⁷ and upheld bylaw provisions that assign the defendant's expenses and costs to the plaintiff if the suit is not approved.⁵⁸ However, it is important to note that the amendments to the Delaware General Corporation Law address internal corporate claims regarding the balance of power between investors and management that should be regulated by the state of incorporation. Thus, other types of shareholders claims, such as federal securities litigation, are potentially not subject to these amendments.⁵⁹

Generally, private ordering is considered to be an expression of law sources' multiplicity because it is an important non-state governance system that regulates the conduct of business organizations and supplements the formal state system of corporate law. However, there are certain limitations on the ability of corporations and their insiders to engage in private ordering for regulating entire governance challenges.⁶⁰ *First*, while in theory corporate participants can control a company's internal power relations through private ordering devices, in practice "specify[ing] all aspects of their relationship and accompanying rights and duties" entails high contracting costs.⁶¹ Therefore, to be willing to engage with such a process, corporate participants compare between the ex-ante benefits of adhering to the default rules and the ex-ante costs of creating an extensive array of customized rules.⁶² *Second*, courts have made clear that corporate law is not only an expression of private law but also aims to accomplish public policy goals, and private ordering devices that violate these purposes will not be enforceable.⁶³ For example, fiduciary obligations protect the interests of shareholders from managerial misconduct and entail a public benefit in the form of lowering the cost of raising capital to the firm. Without enforceable fiduciary duties, investors will demand higher returns in exchange for engaging with the company's business activities, thereby increasing the firm's capital cost.⁶⁴ *Third*, private ordering devices are produced by corporate insiders exclusively and, generally, stakeholders such as consumers and suppliers do not have a voice on the content of such arrangements. Therefore, there is a concern that the content of a private ordering arrangement will undermine stakeholders' rights that are generally addressed by the doctrines of shareholders' limited liability and corporate separate

57. See *Boilermakers Local 154 Ret Fund v Chevron*, 73 A (3d) 934 (Del Ch 2013).

58. See *ATP Tour*, *supra* note 41.

59. See *Salzberg v Sciabacucchi*, 227 A (3d) 102 (Del 2020) (stating that issues relating to shareholders' right to sue under the provision of Securities Act of 1933 are not part of a corporation's internal affairs, and, therefore, can be governed by private ordering techniques that were adopted in the charter or bylaws).

60. See James D Cox, "Corporate Law and the Limits of Private Ordering" (2015) 93:2 Washington University Law Review 257.

61. *Ibid* at 260-61.

62. *Ibid* at 261.

63. See *Sterling v Mayflower Hotel Corp*, 93 A (2d) 107 at 118 (Del 1952). See also Megan Wischmeier Shaner, "Privately Ordered Fiduciaries" (2020) 28:1 Geo Mason L Rev 345 at 355-60.

64. See Cox, *supra* note 60 at 280-81.

legal personality.⁶⁵ Moreover, private ordering devices should also be constrained when they are carried out in companies with concentrated ownership structure, because decision-making rights are generally allocated to controlling shareholders and their representatives on the board of directors who can act against the interests of minority shareholders.

By allowing the existence of non-state governance regimes, countries acknowledge the notion that numerous systems of law govern the conduct of business organizations, and regulation is an enterprise shared by public and private actors alike.⁶⁶ While private ordering mechanisms represent an important aspect of pluralism, they do not capture the unavoidable plurality of values embodied in governance rules that are solely a product of state law aiming to accomplish public goals.⁶⁷ Thus, the plurality of corporate laws' sources is inherently limited because it does not reflect the richness of values embodied in governance rules that are not chosen by corporate organs but are instead imposed by courts following certain factual scenarios. The diversity of corporate laws' values invites a discussion on whether the system of one-size-fits-all should be sustained or instead whether courts should have to produce nuanced rules that capture more accurately the substantial variations in the balance of power between insiders and outsiders, as well as the conditions of the relevant markets and industries.⁶⁸

65. *Ibid* at 279-80.

66. See Steven L Schwarcz, "Private Ordering" (2002) 97:1 Nw UL Rev 319 at 319-22.

67. This observation also follows the scholarship of Gillian Hadfield, who argued that the law serves plural goals and its production should be split into two categories. One category focuses on accomplishing efficiency objectives and has to be produced by private parties and communities. Another one serves justice and democratic legitimacy, which has to remain in the hand of the government and courts. See e.g. Gillian K Hadfield, "The Public and the Private in the Provision of Law for Global Transactions" in Volkmar Gessner, ed, *Contractual Certainty in International Trade: Empirical Studies and Theoretical Debates on Institutional Support for Global Economic Exchanges* (Hart, 2009) 239.

68. See David F Larcker & Brian Tayan, "Loosey-Goosey Governance: Four Misunderstood Terms in Corporate Governance" (7 October 2019) Rock Center for Corporate Governance at Stanford University Closer Look Series: Topics, Issues and Controversies in Corporate Governance No CGRP-79, 2019, at 1, online: <https://ssrn.com/abstract=3463958> ("[o]ur understanding of governance suffers from two problems. *The first problem is the tendency to overgeneralize across companies—to advocate common solutions without regard to size, industry, or geography, and without understanding how situational differences influence correct choices.* The second problem is the tendency to refer to central concepts or terminology without first defining them" [emphasis added]); Zohar Goshen & Richard Squire, "Principal Costs: A New Theory for Corporate Law and Governance" (2017) 117:3 Colum L Rev 767 at 826 ("[t]he inescapable tradeoff between principal costs and agent costs cautions against . . . one-size-fits-all regulations"); Matthew D Cain et al, "How Corporate Governance Is Made: The Case of the Golden Leash" (2016) 164:3 U Pa L Rev 649 at 697 (claiming that "governance intermediaries'" market-wide pronouncements that particular governance terms are "universally harmful (or beneficial)" are "suspect" based on evidence that "one size does not fit all"); Jeffrey L Coles, Naveen D Daniel & Lalitha Naveen, "Boards: Does one size fit all?" (2008) 87:2 Journal of Financial Economics 329 at 351-52 (presenting evidence that the shareholder-value effects of board size differ according to firm-specific dimensions).

II. The Plurality of Corporate Law's Values—Theoretical Foundations

In this Part, we discuss the theoretical background generating the plurality of corporate law's values. This framework is based on the social complex systems idea that was designed in line with chaos theory and networks theory in the field of natural sciences.⁶⁹ These theories are grounded on the assumption that individuals and organizations do not operate in isolation, but rather develop via interaction with their physical and social environment. We discuss the sociological understanding of complexity and social systems and its applications in the study of corporate law.⁷⁰

A. Social Systems Theory, and Its Implications for the Study of Business Organizations

The first formulation of systems theory in social science is associated with the work of Talcott Parsons, who developed a sociological systems theory whereby social systems are related either to the internal environment of other social systems, or to external, non-social environments.⁷¹ Parsons distinguished between four possible formations of social systems:⁷² *adaptive systems* (combining external reference and future orientation—e.g., the economy); *goal-attainment systems* (internal and future orientation—e.g., the polity); *systems focused on integration of system elements* (internal orientation, such as the community); and *systems responsible for maintaining long-term patterns* (present-time external references—e.g., cultural institutions in society).⁷³ These systems share several characteristics, such as *adaptation* (a system must adapt to its environment); *goal attainment* (a system must define and achieve its primary goals); *integration* (a system must maintain a relationship with its other parts); and *latency* (a system must maintain and renew the motivation of individual and cultural patterns that create and sustain that motivation).⁷⁴

One hallmark of Parsons' theory is the notion that all systems and component subsystems are *decomposable*: every subsystem is a system in its own right, and must therefore be distinct in its terms and be free to develop subsystems of its own to be able to persist.⁷⁵ Social systems are sustained through sequences of

69. See Stefan Thurner, Rudolf Hanel & Peter Klimek, *Introduction to the Theory of Complex Systems* (Oxford University Press, 2018) at 1; Nobles & Schiff, *supra* note 22 (examining the ability of modern systems theory to provide a foundation engaging in the study of pluralistic legal orders).

70. See also Goergen, *supra* note 10 at 81.

71. See Talcott Parsons, *The Social System* (Routledge, 1991).

72. See Talcott Parsons, "On Building Social Systems Theory: A Personal History" (1970) 99:4 *Daedalus* 826 at 830.

73. *Ibid* at 844.

74. See Parsons, *supra* note 71 at 1-15; Talcott Parsons & Neil J Smelser, *Economy and Society: A Study in the Integration of Economic & Social Theory* (Routledge, 1956) at 199.

75. See Fremont E Kast & James E Rosenzweig, "General Systems Theory: Applications for Organization and Management" (1972) 15:4 *The Academy of Management Journal* 447 at 450.

linked individual-level behaviors,⁷⁶ and every social system must fulfill these four functions in order to survive, or to perform well.⁷⁷ Moreover, systems and subsystems are interrelated through the input and output of resources that are conveyed in exchange processes between systems.⁷⁸

Parsons' systems theory maintains that each system encompasses several elements that make the system a functional whole.⁷⁹ Thus, each system must be considered in relation to the other systems that can cause a change or reaction within the primary system.⁸⁰ For example, according to systems theory, modern society includes separate subsystems of communication: the economic system, the political system, mass media, science, the education system, the legal system, and religion. These subsystems apply unique code and communicate it to other subsystems. For example, in the field of the law, the code applied is legal/illegal; in the economy, the relevant code is payment/nonpayment; in mass media, the code is information/noninformation; in religion, the code is sin/virtue.⁸¹

This view was further developed by Walter F. Buckley, who formulated the idea of a *complex adaptive system*.⁸² Complex adaptive systems are individual cases of complex systems.⁸³ They are *complex* in the sense they are diverse and composed of multiple, interconnected elements that can change and learn from experience.⁸⁴ Typical examples of complex adaptive systems are climate; cities; firms; markets; governments; industries; social networks; the brain; the immune system; and the cell.⁸⁵

There are two commonly observed features of complex systems: a large number of interacting elements, and emergent properties.⁸⁶ In particular, complex systems tend to comprise a large number of elements that interact with one another.⁸⁷

76. See Parsons, *supra* note 71 at 25.

77. *Ibid* at 5-6.

78. See Cristina Mele, Jacqueline Pels & Francesco Polese, "A Brief Review of Systems Theories and Their Managerial Applications" (2010) 2:1-2 *Service Science* 126 at 129; David Byrne & Gill Callaghan, *Complexity Theory and the Social Sciences: The State of the Art* (Routledge, 2014) at 95-100.

79. See Parsons, *supra* note 72 at 849.

80. See Michael C Jackson, *Systems Thinking: Creative Holism for Managers* (John Wiley & Sons, 2003) at 3 ("[s]imply defined, a system is a complex whole the functioning of which depends on its parts and the interactions between those parts. . . . The whole emerges from the interactions between the parts, which affect each other through complex networks of relationships. Once it has emerged, it is the whole that seems to give meaning to the parts and their interactions").

81. See Nobles & Schiff, *supra* note 22 at 270.

82. See Walter Buckley, *Society—A Complex Adaptive System: Essays in Social Theory* (Gordon & Breach, 1998) at 77.

83. See Ted Carmichael & Mirsad Hadžikadić, "The Fundamentals of Complex Adaptive Systems" in Ted Carmichael, Andrew J Collins & Mirsad Hadžikadić, eds, *Complex Adaptive Systems: Views from the Physical, Natural, and Social Sciences* (Springer, 2019) 1 at 7-8.

84. See Mele, Pels, & Polese, *supra* note 78 at 131.

85. See John H Miller & Scott E Page, *Complex Adaptive Systems: An Introduction to Computational Models of Social Life* (Princeton University Press, 2007) at 9-32.

86. See Benoit Morel & Rangaraj Ramanujam, "Through the Looking Glass of Complexity: The Dynamics of Organizations as Adaptive and Evolving Systems" (1999) 10:3 *Organizational Science* 278.

87. See Jackson, *supra* note 80 at xv.

These interactions are usually linked to the presence of feedback mechanisms in the system—and these, in turn, introduce nonlinearities into the dynamics of the system.⁸⁸ Organizations are complex systems—in the sense that they are made of interactive, adaptive agents, groups, and departments—that communicate with one another through feedback mechanisms.⁸⁹ In addition to the existence of numerous interacting components, complex systems often exhibit *emergent properties*—i.e., the appearance of patterns due to the collective behavior of the system’s components.⁹⁰ One commonly cited example of an emergent property in thermodynamics is the temperature or pressure of a gas, from the large number of molecules striking each other.⁹¹

There are several basic approaches that organizations can adopt to decide how to deal with increased environmental complexity.⁹² One method is complexity reduction by means of a centralized and hierarchical structure of management that focuses exclusively on the manifestation of sole goal.⁹³ Under complexity conditions, members of hierarchical organizations reduce the number of agents and the various data inputs that influence their behavior and conduct.⁹⁴ Thus, an organization determines and prioritizes its goals, and then obtains and mobilizes resources to achieve them.⁹⁵

A second method is to allow organizations to absorb information in non-linear ways, through network relationships.⁹⁶ To consume vast data inputs and internally consider the increased range of risks and opportunities that they may be exposed to, firms should be composed of a network of decentralized decision-making structures that replace the centralized ones.⁹⁷ These decentralized structures are thought to be superior in dealing with the increased complexity of internal and external environments.⁹⁸ According to this view, the board of directors could distribute its functions to several sub-committees, which are responsible for managing complex data inputs in their respective field of expertise and executing the related decision-making process.⁹⁹

88. See Kast & Rosenzweig, *supra* note 75 at 450.

89. See Morel & Ramanujam, *supra* note 86 at 279-80.

90. See Carmichael & Hadžikadić, *supra* note 83 at 7.

91. See Morel & Ramanujam, *supra* note 86 at 280.

92. See Max Boisot & John Child, “Organizations as Adaptive Systems in Complex Environments: The Case of China” (1999) 10:3 *Organization Science* 237 at 237-38.

93. See Michael Pirson & Shann Turnbull, “Decentralized Governance Structures Are Able to Handle CSR-Induced Complexity Better” (2018) 57:5 *Business & Society* 929 at 936.

94. See Boisot & Child, *supra* note 92 at 237 (demonstrating that China’s “organizations and other social units have correspondingly handled this complexity through a strategy of absorption rather than the reduction strategy”).

95. See Donde P Ashmos, Dennis Duchon & Reuben R McDaniel Jr, “Organizational responses to complexity: the effect on organizational performance” (2000) 13:6 *Journal of Organizational Change Management* 577 at 582.

96. See Boisot & Child, *supra* note 92.

97. See Pirson & Turnbull, *supra* note 93 at 943-48.

98. *Ibid* at 935.

99. *Ibid* at 936-37.

A third method focuses on the collaborative efforts and network connectivity within the judiciary system and between courts, legislators, and regulators.¹⁰⁰ In particular, studies on judicial hierarchy have crafted several models for explaining vertical and horizontal learning capabilities among judges. For example, David Klein explored how federal court judges in the United States decide cases when faced with unsettled law issues.¹⁰¹ By employing quantitative and qualitative inquiries, he found that judges were often convinced by their colleagues' reasoning, actions, prestige, expertise, and experience that lead judges "across circuits to agree on the proper rule more often than not."¹⁰² Moreover, when there are conflicts among judges' reasoning and rulings' outcomes, judges are more likely to support the reasoning favored by a majority of the circuits, implying that judges are engaged in vertical learning.¹⁰³ Given the intense connectivity within and between various legal institutions, information flow channels aiming to redress the complexity of the corporate governance system will emerge.

Since the complexity framework provides theoretical grounds for skepticism about uniform policies or structures of governance that are applicable in all contexts, courts have to break down the system of corporate governance regimes into its component parts, and examine how these parts relate to each other.¹⁰⁴ By analyzing the elements of corporate governance that interact with each other, the legal community—and the companies themselves—achieve a comprehensive perception of the field, which in turn affects business performance.

B. A Firm-Specific View of Corporate Governance Arrangements

Before elaborating on how corporate governance regimes must be designed at the firm level, we distinguish between internal and external corporate governance arrangements. *Internal corporate governance regimes* refer to arrangements regulating the specific power relations between a controlling shareholder and minority shareholders or between shareholders and management. These regulatory devices include controlling shareholders' fiduciary duties, related party transactions regulations,¹⁰⁵ managerial incentives,¹⁰⁶ and directors' fiduciary duties.

100. See Ruhl & Katz, *supra* note 10 at 238.

101. See David E Klein, *Making Law in the United States Courts of Appeals* (Cambridge University Press, 2002).

102. John P Kastellec, "The Judicial Hierarchy" in William R Thompson, ed, *Oxford Research Encyclopedia of Politics* (Oxford University Press, 2017).

103. See Stefanie A Lindquist & David E Klein, "The Influence of Jurisprudential Considerations on Supreme Court Decisionmaking: A Study of Conflict Cases" (2006) 40:1 *Law & Soc'y Rev* 135.

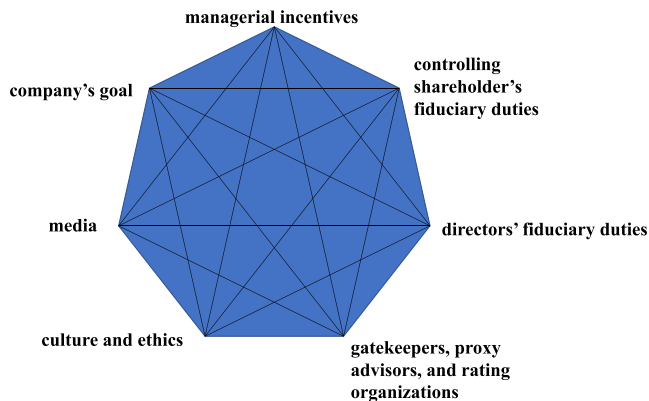
104. See Mark A Chinen, "Governing Complexity" in Murray, Webb & Wheatley, *supra* note 12 at 151.

105. See Luca Enriques & Tobias H Tröger, eds, *The Law and Finance of Related Party Transactions* (Cambridge University Press, 2019).

106. See Randall S Thomas & Christoph Van der Elst, "Say on Pay Around the World" (2015) 92:3 *Washington University Law Review* 653.

External corporate governance mechanisms are arrangements that regulate the relationship between the company as a separate and independent legal entity, and third parties—such as the company goal;¹⁰⁷ the market for corporate control;¹⁰⁸ gatekeepers;¹⁰⁹ stakeholder activists;¹¹⁰ proxy advisors;¹¹¹ rating organizations;¹¹² the media;¹¹³ ethics; and culture.¹¹⁴ As illustrated below, the complexity of the corporate governance eco-system is evident in the interactions between individual governance regimes. These continuous interactions produce extensive plurality in the values and principles that corporate law has to accomplish. Moreover, these special exchanges create normative implications that differ among numerous companies operating in various markets. For the law to be able to attain wide-ranging values, it has to design governance rules that are sensitive to the special features of firms and industries. As a result, adherence to a ‘one-

Figure 1. The Complexity of Corporate Governance Systems.



This figure displays an interactions diagram of internal and external corporate governance regimes. Each vector represents the particular interaction between two separate governance arrangements. Courts must be attentive to the values produced from the power and magnitude of each interface for various firms.

107. For a comparative analysis of directors' fiduciary duties in the Anglo-American world, see Jennifer G Hill, "Shifting Contours of Directors' Fiduciary Duties and Norms in Comparative Corporate Governance" (2020) 5 UC Irvine Journal of International, Transnational, & Comparative Law 163.

108. See Ruth V Aguilera et al, "Connecting the Dots: Bringing External Corporate Governance into the Corporate Governance Puzzle" (2015) 9:1 The Academy of Management Annals 483 at 505-07.

109. *Ibid* at 530-32.

110. *Ibid* at 534-37.

111. See Andrew F Tuch, "Proxy Advisor Influence in a Comparative Light" (2019) 99:3 BUL Rev 1459.

112. See Aguilera et al, *supra* note 108 at 532-34.

113. See Michael K Bednar, "The Role of the Media in Corporate Governance" in Michael A Hitt & Ramon J Aldag, eds, *Oxford Research Encyclopedia of Business and Management* (Oxford University Press, 2017).

114. See Amir N Licht, "Culture and Law in Corporate Governance" in Jeffrey N Gordon & Wolf-Georg Ringe, eds, *The Oxford Handbook on Law and Corporate Governance* (Oxford University Press, 2018) 129.

size-fits-all' approach prevents corporate law from meeting the challenge of complexity by crafting tailor-made law.¹¹⁵

Consequently, to provide an expressive formulation of governance mechanisms, the law must be articulated in line with the balance of power between insiders and outsiders. The following discussion analyzes the primary manifestations of these power relations in concentrated and diffuse ownership structures of public companies.

1. Heterogeneity of Corporate Participants

To provide an expressive formulation of governance mechanisms at the firm level, we must first recognize that the group of shareholders that the law wishes to protect is not homogeneous in terms of their respective interests.¹¹⁶ Shareholders may differ from each other in several respects—such as in the ratio of their holdings; the length of their investment;¹¹⁷ their diversified or undiversified investment portfolios;¹¹⁸ the rights and obligations attached to their shares;¹¹⁹ and their social and political views.¹²⁰ In particular, courts must distinguish between five types of shareholders: controlling shareholders; retail investors; institutional investors; hedge funds; and index funds.¹²¹

Controlling shareholders invest a considerable amount of their capital in a given corporation, and have an incentive to supervise the decision-making process of the company's management.¹²² They bear these costs because that

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115. See also Barry D Baysinger & Henry N Butler, "Race for the Bottom v Climb to the Top: The ALI Project and Uniformity in Corporate Law" (1985) 10:2 J Corp L 431 at 456 ("any imposition of uniformity—either liberal or strict—on the system of corporate law will be Pareto inefficient").
116. See Umakanth Varottil, "Minority Shareholders' Rights, Powers and Duties: The Market for Corporate Influence" (2020) National University of Singapore Law Working Paper 2020/006 (arguing that the current corporate governance paradigm fails to account for the diversity among minority shareholders and their interests).
117. See Robert Anderson IV, "The Long and Short of Corporate Governance" (2015) 23:1 Geo Mason L Rev 19 at 26.
118. See Amir Rubin, "Diversification and Corporate Decisions" (2006) 3:3 Corporate Ownership & Control 209 (discussing several issues that are significantly affected by shareholders' diversification, such as the monitoring role of the board of directors, the rationale behind corporate social responsibility, the optimality of capital budgeting decisions, and the objective of executive compensation policies).
119. See EC, *Rights and Obligations of Shareholders—National Regimes and Proposed Instruments at EU Level for Improving Legal Efficiency* (Study) by Frank Martin Laprade in collaboration with Phillipe Portier et al (European Parliament, 2012) at 17-20.
120. See Iman Anabtawi, "Some Skepticism About Increasing Shareholder Power" (2006) 53:3 UCLA L Rev 561 at 575.
121. See John C Coates IV, "Thirty years of evolution in the roles of institutional investors in corporate governance" in Jennifer G Hill & Randall S Thomas, eds, *Research Handbook on Shareholder Power* (Edward Elgar, 2015) 79 at 80-88.
122. See Ronald J Gilson & Jeffrey N Gordon, "Controlling Controlling Shareholders" (2003) 152:2 U Pa L Rev 785 at 789 ("[t]he legal rules governing private benefits of control in operating a company set the limits on the price of monitoring by a controlling shareholder. If these limits are effective, the presence of a controlling shareholder benefits the non-controlling shareholders because the reduction in managerial agency costs will exceed the level of private benefits").

structure enables them to execute long-term visions of the company's business activities.¹²³ Due to the *collective action problem* and *rational apathy*, retail investors do not actively participate in the decision-making of corporations with regard to improving their internal governance practices.¹²⁴ However, increased engagement of institutional investors—such as pension funds and insurance companies—does have the potential to improve corporate decision-making, and provides protection against excessive risk-taking.¹²⁵ This positive influence is evident in the emergence of stewardship codes that aim to constrain board power by encouraging shareholders to exercise their legal rights and increase their level of participation.¹²⁶ In contrast, hedge funds are perceived to have a negative effect on the company's decision-making process, because they use aggressive tactics to force the management to enhance share value only in the short term.¹²⁷ By using innovative investment instruments such as financial derivatives and security loan transactions, they hedge themselves against financial risks, while maintaining an active role in the company's operations.¹²⁸ For example, they might pressure the management to distribute a dividend to shareholders,¹²⁹ or induce the company to sell business divisions, or reduce its research and development costs, and adopt various legal measures, with a view to seizing control of companies in financial distress.¹³⁰ Index funds are a type of mutual fund with a portfolio constructed to match or track the components of a financial market index.¹³¹ Investment managers of index funds are considered to have little incentive to oversee the operations of the companies in their portfolio because they would only partly benefit from such oversight, while bearing the full costs involved.¹³² Since investment managers seek to ensure future business activity

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123. See Albert H Choi, "Concentrated Ownership and Long-Term Shareholder Value" (2018) 53:1 *Harvard Business L Rev* 53 at 67-74.
124. See Bernard S Black, "Shareholder Passivity Reexamined" (1990) 89:3 *Mich L Rev* 520 at 575-91 (arguing that substantial holdings and economies of scale make it possible to overcome shareholder passivity).
125. See Jennifer G Hill, "Good Activist/Bad Activist: The Rise of International Stewardship Codes" (2018) 41:2 *Seattle UL Rev* 497 at 503-06.
126. See Dionysia Katelouzou, "Shareholder Stewardship: A Case of (Re)Embedding Institutional Investors and the Corporation?" in Beate Sjøfjell & Christopher M Bruner, eds, *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, 2020) 581.
127. See John C Coffee, Jr & Darius Palia, "The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance" (2016) 41:3 *J Corp L* 545 at 549-50.
128. See Leo E Strine, Jr, "Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System" (2017) 126:6 *Yale LJ* 1870 (exploring how the conduct of hedge funds is harmful to the American public and economy). For the opposite view, Lucian A Bebchuk, Alon Brav & Wei Jiang, "The Long-Term Effects of Hedge Fund Activism" (2015) 115:5 *Colum L Rev* 1085 at 1155.
129. See Coffee & Palia, *supra* note 127 at 573.
130. See Frank Partnoy, "US Hedge Fund Activism" in Hill & Thomas, *supra* note 121 at 104.
131. See Jill Fisch, Asaf Hamdani & Steven Davidoff Solomon, "The New Titans of Wall Street: A Theoretical Framework for Passive Investors" (2019) 168:1 *U Pa L Rev* 17 at 19.
132. See Lucian Bebchuk & Scott Hirst, "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy" (2019) 119:8 *Colum L Rev* 2029 at 2050-59 (proposing reforms that policymakers should consider addressing the incentives of index fund managers to underinvest in stewardship and incentives, in excessive deference to managers' positions).

with the company they are invested in, they will generally not undermine the management's judgment or act against its position.¹³³ Consequently, the establishment of governance mechanisms for regulating firm-specific power relations cannot be made without analyzing the heterogeneous nature of corporate participants and their special interests and strategies.

2. Heterogeneity of Corporate's Internal Power Relations

Generally speaking, the ownership structure of a public company is indicative of the inherent agency conflict that the law must address.¹³⁴ Empirical evidence demonstrates the multi-dimensionality effect of diffuse or concentrated ownership structure on enhancing firm performance and mitigating agency costs.¹³⁵ Specifically, it has been found that small levels of concentrated ownership control increase a company's value, but when a certain threshold level is reached to the point that there is a substantial risk that controlling shareholders will seize corporate resources, the cost of that structure exceeds its benefits in reducing agency costs.¹³⁶ This suggests that a diffuse or concentrated structure in and of itself cannot exclusively explain a firm's performance, which may be subjected to the complex effects of other internal and external factors.

In the following section, I suggest that for ownership structure to be an effective indicator of reduced agency costs, courts must apply a firm-specific perspective by considering the relative ratio of holdings between various shareholders, as well as the chances of creating an effective oppositional alliance of shareholders against the management or the controlling shareholder. The actual power relationship between insiders and outsiders may also be reflected in the composition and operation of the board. For example, the greater the holdings of minority shareholders in a concentrated ownership structure, the greater the chances that the board's composition will have significant oversight impact on the controlling shareholder's conduct. Another related factor for observing the formulation of an oppositional alliance is the extent of holdings by institutional investors, and the degree of dispersion of holdings among retail investors. Accordingly, the broader the distribution of shares by retail investors and the smaller the size of institutional investors' holdings, the lower the chances of creating such an active opposition. Conversely, the narrower the distribution of shares by retail investors, and the larger the size of institutional investors' holdings, the higher the chances of creating such an opposition.¹³⁷

133. *Ibid* at 2059-71.

134. See Kraakman, *supra* note 6 at 24-27.

135. See Benjamin Balsmeier & Dirk Czarnitzki, "Ownership Concentration, Institutional Development and Firm Performance in Central and Eastern Europe" (2017) 38 *Managerial & Decision Economics* at 178.

136. *Ibid* at 188-89.

137. See Assaf Hamdani & Sharon Hannes, "The Future of Shareholders Activism" (2019) 99:3 *BUL Rev* 971 at 982 (arguing that "the increase in size of the stakes owned by large institutional investors suggests that money managers may capture substantial gains from improved share value at portfolio companies").

3. *Heterogeneity of Industries in Which Companies Operate*

The company's area of services—including its business condition—is also a relevant factor when assessing the power relationship between insiders and outsiders. In this regard, the law must design the legal arrangement that regulates such power relations, in a manner that helps maximize the company's value. In the following, I discuss the implications of the company's area of activities, including its business condition, on the extent of protection that law should provide to shareholders with regard to the legitimate interests of insiders.

(a) Protection of shareholders' rights in research and development companies

Generally, an IPO is a common method for raising funds to expand company's research and development undertakings, or to reduce its debt levels.¹³⁸ It involves the obligation of the listed company to comply with strict regulations regarding mandatory disclosure and preventing managerial misconduct.¹³⁹ These rules include listing requirements to determine whether a company is eligible to go public; disclosure and transparency guidelines to provide financial information to the market; and corporate governance requirements to ensure that the company's affairs are managed in the interests of all shareholders.¹⁴⁰ This regulatory framework makes the process of an IPO significantly expensive, and includes various costs—such as the fees paid to investment banks, accountants, auditors, lawyers, and other service providers for advice and preparation of the registration statements, prospectus, and other relevant legal documents.¹⁴¹

Since the early 1990s, the business landscape has shifted from large and public corporations to startups, entrepreneurial firms, and SMEs (small or medium-sized enterprises)—particularly in the technology sector.¹⁴² In this respect, it has been argued that “these costly and lengthy regulatory barriers, together with sluggish IPO markets and their unavailability to smaller firms, have been reasons for high-tech companies and their shareholders to look for alternatives to IPOs.”¹⁴³

138. See John Rust & Sudip Gupta, “A Simple Theory of Why and When Firms Go Public” (Paper delivered at the Theory & Inference in Capital Market Research Conference, Stanford Graduate School of Business, 8 December 2017) [unpublished] at 6–18, online: <https://stanford.io/3noV5uR>.

139. See Frank H Easterbrook & Daniel R Fischel, “Mandatory Disclosure and the Protection of Investors” (1984) 70:4 Va L Rev 669 at 670.

140. See James D Cox et al, *Securities Regulation: Cases and Materials*, 9th ed (Wolters Kluwer, 2020) at 553.

141. See Randolph P Beatty & Ivo Welch, “Issuer Expenses and Legal Liability in Initial Public Offerings” (1996) 39:2 JL & Econ 545 (exploring how expert compensation, IPO underpricing, and IPO underpricing uncertainty are related to (1) expert quality, (2) legal caution and liability, (3) nonlegal risk signals, and (4) one another).

142. See Michael J Mauboussin & Dan Callahan, “Public to Private Equity in the United States: A Long-Term Look” (2020) online (pdf): [Morgan Stanley mgstn.ly/3k225vy](https://www.morganstanley.com/public-to-private-equity).

143. Erik PM Vermeulen, “High-Tech Companies and the Decision to ‘Go Public’: Are Backdoor Listings (Still) an Alternative to ‘Front-door’ Initial Public Offerings?” (2015) 4:1 Penn State Journal of Law & International Affairs 421 at 421. Moreover, as Elizabeth Pollman has

High-tech entrepreneurial firms are grounded on one basic vision, or project.¹⁴⁴ The riskiness of the project is extremely high; cannot be diversified; is often associated with a ‘winner-takes-it-all’; and has a high probability of failure and bankruptcy.¹⁴⁵ The starting point in analyzing corporate governance in entrepreneurial firms is the entrepreneur himself, who represents the firm’s owner-manager.¹⁴⁶ Entrepreneurial firms are strongly associated with the specific human capital, skills, and experience of the founder/owner-manager. These constitute the firm’s complementary assets, which are essential for its success.¹⁴⁷ In these conditions, the rules of corporate governance must be designed to give higher priority to the interests of the founder/owner-manager over the rights of other constituencies involved in the company’s operations—at least for a limited period. The reason for this is that, in the first years after these companies issue their shares, the entrepreneur holds the core technology and business knowledge necessary to the company’s continued development to the point where it becomes an established business. To encourage entrepreneurs to commit to the long-term prospects of their companies and to give them relative certainty concerning their continued engagement with its business, special corporate governance regimes should be adopted to incentivize entrepreneurs to list their companies on the stock exchange.

(b) Protection of shareholders’ rights in corporations whose operations affect the market’s financial stability

This criterion links the level of protection afforded to shareholders to the business environment and the company’s contribution to the overall financial stability of

recently pointed out, startups involve heterogeneous shareholders in overlapping governance roles that give rise to vertical and horizontal conflicts between founders, VCs, common investors, executives, and employees. These tensions tend to escalate as the company matures and the number of participants with varied interests and claims increases. Thus, staying private with an increasingly diverse group of shareholders involves significant costs relating to negotiating new financing rounds, managing information flows, and meeting various liquidity needs. Due to governance costs and liquidity pressures, startups choose to go public even if they do not need to raise money, or embrace mechanisms to provide partial liquidity—such as third-party tender offers, and company-sponsored share buybacks. See Elizabeth Pollman, “Startup Governance” (2020) 168:1 U Pa L Rev 155. However, it should be emphasized that Pollman’s argument refers to startup companies at the *later* stages of their life cycle, while our discussion refers to startup companies at the *early* stage of their life cycle.

144. See Hemant Taneja & Ken Chenault, “Building a Startup That Will Last” (8 July 2019), online: *Harvard Business Review* <https://hbr.org/2019/07/building-a-startup-that-will-last> (“[a] successful startup is often driven by the vision of its founders and their core team”).
145. See Alexandra Andhov, “Importance of start-up law for our legal systems” in Alexandra Andhov, ed, *Start-Up Law* (Edward Elgar, 2020) 9 at 21.
146. See Fabio Bertoni, Massimo G Colombo & Annalisa Croce, “Corporate Governance in High-Tech Firms” in Douglas Michael Wright et al, eds, *The Oxford Handbook of Corporate Governance* (Oxford University Press, 2013) 365 at 368-71.
147. See Massimo G Colombo, Annalisa Croce & Samuele Murtinu, “Ownership structure, horizontal agency costs and the performance of high-tech entrepreneurial firms” (2014) 42 *Small Business Economics* 265 (results of a sample of Italian high-tech entrepreneurial firms show that the number of owner-managers has a positive effect on firm performance, while the effect of the number of non-managerial individual shareholders is negligible).

the capital market. The larger the impact a proposed transaction will have on the financial stability of the economy as a whole, the greater the restrictions that should be placed on insiders. The operations of financial institutions involve various risks—such as credit risks; liquidity risks; operational risks; legal risks; and market risks—all of which have an impact on overall financial stability. In this regard, adequate corporate governance arrangements are critical to the proper functioning of the banking sector, and the economy as a whole.¹⁴⁸ The Basel Committee's revised corporate governance principles provide a framework that banks and supervisors should operate within to achieve robust and transparent risk management and decision-making, and to promote public trust in the safety and security of the banking system.¹⁴⁹

The conduct of a financial institution involves two different sets of agency costs.¹⁵⁰ One is a concern that the controlling shareholder of the institutional body will steer the company's business operations in a manner that will allow them to pocket the private benefit of their control, at the expense of minority shareholders' interests. The second agency problem is that investment managers have little incentive to address corporate governance issues that may eventually impair the corporate performance of companies in their portfolio, and consequently do not develop the expertise needed to engage in such activity, even if it would benefit their beneficiaries.¹⁵¹ The reason for this is that under existing regulations, investment managers cannot charge their personnel and other management expenses related to stewardship of any single corporation directly to the portfolio.¹⁵² Thus, if an investment manager would like to conduct a proxy fight against incumbent managers, it would have to cover these expenses itself, out of the fee income it receives from investors.¹⁵³ The tangential connection between these two agency costs lies in the importance of restraining insiders' power to engage in related party transactions that have a bearing upon the corporation's benefit and market stability.¹⁵⁴ This is especially required in times of global financial distress, such as the recent pandemic crisis, in which the entire economy bears the residual

148. The absence of appropriate corporate governance rules contributed to the economic crisis of 2007-09. See Simon Deakin, "Corporate Governance and Financial Crisis in the Long Run" in Cynthia A Williams & Peer Zumbansen, eds, *The Embedded Firm: Corporate Governance, Labor, and Finance Capitalism* (Cambridge University Press, 2011) 15 at 17.

149. See Basel Committee on Banking Supervision, "Guidelines: Corporate governance principles for banks" (2015) at 5, online (pdf): *Bank for International Settlements* <https://bit.ly/3C8QIIB>.

150. Ronald J Gilson & Jeffrey N Gordon, "The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights" (2013) 113:4 Colum L Rev 863 at 874-89.

151. *Ibid* at 890.

152. See Lucian A Bebchuk, Alma Cohen & Scott Hirst, "The Agency Problems of Institutional Investors" (2017) 31:3 Journal of Economic Perspectives 89 at 96-97.

153. *Ibid* at 96.

154. See Alessandro Romano, Luca Enriques & Jonathan R Macey, "Extended Shareholder Liability for Systemically Important Financial Institutions" (2020) 69:3 Am U L Rev 967 at 967.

risks of the financial firm's failure.¹⁵⁵ Unlike stakeholders who contracted with the firm, it cannot negotiate any contractual protections. In this scenario, the controlling shareholder is encouraged to increase the level of risks imposed on creditors by engaging in mistrusted transactions. This incentive can be even more compelling due to the promise of expensive public support in a manner of a "bail-out to make sure that a really large bank does not inflict serious economic damage through its failure."¹⁵⁶ Thus, during financial or social crises, courts have to impose further constraints on a controlling shareholder by considering society's broader interests.

III. Firm-Specific View of Internal Corporate Governance Regimes

This Part demonstrates how courts should design internal corporate governance regimes with a firm-specific perspective—in particular, how the law on fiduciary duties of controlling shareholders, the regulation of related party transactions, and officers' duty of care should be reconstructed.

A. Fiduciary Duties of Controlling Shareholders

Generally, shareholders' duty of loyalty is founded on the principle of equality between the company and its shareholders, who hold an obligation to treat each other with equity and impartiality.¹⁵⁷ Under the conventional view of the Common Law, "[w]hen a shareholder is voting for or against a particular resolution, he is voting as a person owing no fiduciary duty to the company who is exercising his own right of property as he sees fit."¹⁵⁸ A controlling shareholder has no particular duty of loyalty toward the minority shareholders, because it cannot be assumed that the controlling shareholder agreed, at any stage of its business operations, to subordinate their interests to the interests of the minority shareholders.¹⁵⁹ At the same time, each shareholder is still

required to respect a number of obligations which force him to take into account the interests of both his fellow shareholders and 'the company' itself. The shareholder is thus not completely free in how to exercise their voting rights, and cannot pursue purely selfish motives to an unlimited extent.¹⁶⁰

155. See e.g. John Armour & Jeffrey N Gordon, "Systemic Harms and Shareholder Value" (2014) 6:1 *Journal of Legal Analysis* 35 (arguing that the recent financial crisis has demonstrated that shareholder primacy is a faulty guide for managerial action in systemically essential firms).

156. Yesha Yadav, "Too-Big-to-Fail Shareholders" (2018) 103:2 *Minn L Rev* 587 at 650.

157. See Luca Enriques et al, "The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies" in Kraakman, *supra* note 6.

158. *Northern Counties Securities, Ltd v Jackson & Steeple, Ltd*, [1974] 1 WLR 1133 at 1144 (Ch).

159. See Paul L Davies, "Related Party Transactions: UK Model" in Enriques & Tröger, *supra* note 105 at 377 ("[in] line with its 'classic' approach to fiduciary duties, English law does not accept that shareholders, as such, are fiduciaries").

160. Wolf-Georg Ringe, *The Deconstruction of Equity: Activist Shareholders, Decoupled Risk, and Corporate Governance* (Oxford University Press, 2016) at 207-08.

Accordingly, UK courts have dealt with the abuse of majority power primarily through the *unfair prejudice* action, now codified in section 994 of the *Companies Act 2006* (UK).¹⁶¹ While English law protects minority shareholders through ex-post equity-based judicial review,¹⁶² American law incorporates equity consideration by ex-ante constraints on the exercise of shareholder rights and powers.¹⁶³ Under Delaware law, controlling shareholders (much like directors and executives) owe fiduciary duties to the companies they control and to their minority shareholders.¹⁶⁴ Historically, therefore, controlling shareholders' transactions with their own companies have been subject to heightened *entire fairness* scrutiny, rather than the deferential *business judgment* rule review.¹⁶⁵ This implementation of ex-ante equity considerations "implies that the problem of abuse of power by controlling shareholders is generic and of a 'fiduciary' nature, such that fiduciary duties promise an apt resolution of it."¹⁶⁶ A similar approach has been adopted in civil law countries.¹⁶⁷

Considering this state of affairs in light of the general principles of fiduciary law in Common Law legal systems is a puzzle. In general, American fiduciary law follows the structure of the ex-post common law adjudications and judge-made laws and is sharply different from civil law, which follows ex-ante codification.¹⁶⁸ However, the law of controlling shareholders fiduciary duties is more compatible with the ex-ante approach of civil law, rather than with the ex-post approach of English law. Recently, Miller has argued that the preference for fiduciary regulation in American equity—in marked contrast to the preference for the *oppression doctrine* in commonwealth jurisdictions—is questionable. In his view, such an approach can hardly be justified, because it involves an equity intervention that is not sensitive to the real sense of shareholder conflicts and consequent material inequities that are not amenable to effective resolution

161. See Andreas Cahn & David C Donald, *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA* (Cambridge University Press, 2018) at 713-14.

162. See Ernest Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (Cambridge University Press, 2019) at 251.

163. See Paul B Miller, "Equity, Majoritarian Governance, and the Oppression Remedy" in Arthur B Laby & Jacob Hale Russell, eds, *Fiduciary Obligations in Business* (Cambridge University Press, 2021) 171.

164. See *Kahn v Lynch Communication Systems*, 638 A (2d) 1110 at 1115 (Del 1994); *Sinclair Oil Corporation v Levien*, 280 A (2d) 717 at 720 (Del 1971); *In re PNB Holding Co Shareholders Litigation*, 2006 WL 2403999 at 9 (Del Ch); Claire Hill & Brett McDonnell, "Sanitizing Interested Transactions" (2011) 36:3 Del J Corp L 903 at 920-24.

165. See *Americas Mining Corp v Theriault*, 51 A (3d) 1213 (Del 2012) at 1239 ("[w]hen a transaction involving self-dealing by a controlling shareholder is challenged, the applicable standard of review is entire fairness, with the defendants having the burden of persuasion").

166. Miller, *supra* note 163 at 178.

167. See Andreas Cahn, "The Shareholders' Fiduciary Duty in German Company Law" in Hanne S Birkmose, ed, *Shareholders Duties* (Wolters Kluwer, 2017) at 347; Martin Gelter & Geneviève Helleringer, "Fiduciary Principles in European Civil Law Systems" in Evan J Criddle, Paul B Miller & Robert H Sitkoff, eds, *Oxford Handbook of Fiduciary Law* (Oxford University Press, 2019) 583 at 599.

168. See David Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (Cambridge University Press, 2018) at 4: "[m]odern US corporate fiduciary law is deeply rooted in legal principles first formed in, and borrowed from, the United Kingdom."

through general law.¹⁶⁹ To bridge between the American and English approaches, I propose that the law be designed to incorporate the firm-specific power relations between the controlling shareholder and minority shareholders by considering the possibility of forming an active oppositional alliance of shareholders or directors against the interests of controlling shareholders.

In instances where the controlling shareholder holds less than 50% of the share capital and the chances of forming such an alliance are high, comparing the relative holding rates indicates that minority shareholders stand to lose more than the controlling shareholder. In such instances, there is a concern that the controlling shareholder may be privy to private information about the proposed related-party actions that they do not wish to share with the minority shareholders. Thus, there is significant justification for imposing an ex-ante fiduciary obligation on the controlling shareholder. Conversely, when the controlling shareholder holds more than 50% of the voting rights in the company, and the chances of forming an active oppositional alliance are insignificant, the ex-post unfair prejudice doctrine should govern the relationship between controlling and minority shareholders. Though the proposed transaction is considered to benefit corporate's interests and its shareholders, firm-specific power relations indicate that the controlling shareholder stands to lose more than minority shareholders if the transaction fails. Thus, there is no justification for preventing the controlling shareholder from looking after their legitimate business interests, provided that they do not violate minority shareholders' rights. Since the controlling shareholder's ability to deprive minority shareholders from direct participation in the decision-making process may be more observable, it is consistent with English case law, which provides relief for unfair prejudice causes of action in such circumstances.¹⁷⁰

B. Regulation of Related-Party Transactions

Historically, the United States has adopted a strict stance toward related-party transactions by setting a standard of entire fairness, which examines whether the terms of the transaction and its approval process are fair.¹⁷¹ Recently, however, in the *M&F Worldwide Corp* ruling,¹⁷² the Supreme Court of Delaware endorsed the business judgment review for going-private merger transactions in cases where dual procedural protections have been applied.¹⁷³ Specifically,

169. See Miller, *supra* note 163 at 181-185.

170. See Victor Joffe QC et al, *Minority Shareholders: Law, Practice, and Procedure* (Oxford University Press, 2018) at §§7.74-7.83.

171. See Amir N Licht, "Farewell to Fairness: Towards Retiring Delaware's Entire Fairness Review" (2020) 44:1 Delaware J Corp L 1 (in line with the fundamental principles of fiduciary law in Common Law jurisdictions, the article calls on the courts to abolish substantive the fairness review entirely); Zohar Goshen, "The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality" (2003) 91:2 Cal L Rev 393 at 426-29.

172. See *In re MFW Shareholders Litigation*, 67 A (3d) 496 (Del Ch 2013); *Kahn v M & F Worldwide Corp*, 88 A (3d) 635 at 641 (Del 2014) [*MFW*].

173. See "Corporate Law—Mergers and Acquisitions—Delaware Supreme Court Endorses Business Judgment Review for Going-Private Mergers with Dual Procedural Protections—*Kahn v M&F Worldwide Corp*, 88 A3d 635 (Del 2014)", Case Comment, (2015) 128:6 Harv L Rev 1818.

it established that deference to company actions will be provided when the transaction is negotiated by a well-functioning special committee of independent directors and approved by a majority of minority shareholders.¹⁷⁴ However, for the courts to rely on the effectiveness of these mechanisms, the firm-specific perspective posits that they must consider them in light of the actual power relations between insiders and outsiders.¹⁷⁵

These power relations are reflected in the chances of creating an active oppositional alliance of shareholders that can prevail upon the board to conduct meaningful oversight. Accordingly, when the controlling shareholder's holdings are less than 50% of the voting rights, and there is a high likelihood of organizing an oppositional alliance of shareholders, only a procedural judicial review—that focuses purely on the transaction's approval process—should be applied. In such instances, the internal governance mechanisms themselves can ensure that the controlling shareholder does not derive private benefits of control. However, when the controlling shareholder holds more than 50% of the voting rights—and forming an active oppositional alliance of shareholders is therefore unlikely—the composition of the board may reflect the weakness of minority shareholders in impeding the controlling shareholder from obtaining private benefits of control. Thus, as the level of concentrated ownership increases, the effectiveness of independence directors' oversight decreases.¹⁷⁶ Since the effectiveness of the board's oversight is thought to be insubstantial in this case, an ex-post judicial examination of transactions' fairness should be required as well.

C. Officers' Duty of Care

All legal systems consider duty of care to be focused on the informed decision-making process, rather than on the substantive quality of the business decision itself.¹⁷⁷ However, courts have yet to develop a firm-specific duty of care view that designs the required decision-making process according to a company's features, area of operations, and industry.¹⁷⁸ Consider, for example, the relevant

174. The applicability of the *MFW* ruling has been extended to all related-party transactions, and not only to going-private mergers. See *IRA Trust FBO Bobbie Ahmed v Crane*, 2017 WL 7053964 at 11 (Del Ch). See also Edward B Rock, "Majority of the Minority Approval in a World of Active Shareholders" in Enriques & Tröger, *supra* note 105 at 105.

175. See also Leon Yehuda Anidjar, "Toward Relative Corporate Governance Regimes: Rethinking Concentrated Ownership Structure Around the World" (2019) 30:1 *Stan L & Pol'y Rev* 197 at 247.

176. See Ke Li et al, "Board independence, ownership concentration and corporate performance—Chinese evidence" (2015) 41 *International Review of Financial Analysis* 162 (providing evidence that the positive impact of board independence on corporate performance increases as ownership concentration declines).

177. See *In re Walt Disney Co Derivative Litigation*, 907 A (2d) 693 at 746-47 (Del Ch 2005).

178. Interestingly, though, the case law has considered the necessity for firm-specific formulation of the duty of care. See *City Equitable Fire Insurance Company, Re*, [1925] Ch 407 at 426 ("[t]he position of a director of a company carrying on a small retail business is very different from that of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of one insurance company may differ widely for those of a director of another"); *Daniels v Anderson* (1995), 16 ACSR 607 at 668 (NSWCA). Moreover, in

standards of care required for achieving an informed decision-making process in entrepreneurial technology companies.¹⁷⁹ Research and development companies rely on the activity of entrepreneurs to fulfill the current technology demands of various international markets. Such enterprises are particularly risky, due to the difficulty in accurately assessing the scope and characteristics of the potential product market, the level of international competitiveness, and the uncertainty about the company's ability to successfully develop the product and rapidly enter into the relevant market before its competitors. Even if the technological product in question is successfully produced, other events may intervene and derail the company's plans and lead to its rapid demise—for example, when its massive investments over the years in developing the product are rendered moot, due to technological developments that were unforeseen by the company's executives and directors. Such risks justify redesigning the standards of care, and the application of the business judgment rule, in a manner that facilitates entrepreneurial action.¹⁸⁰ Specifically, standards of care should be reformulated so as not to deter executives and directors from embracing risky decisions to venture into new markets that involve a high degree of uncertainty.¹⁸¹

Since innovative conducts involve far more risk or uncertainty than non-innovative alternatives, judicial review of prohibitively risky decisions may subject innovation to doubts by ex-post second-guessing by the courts.¹⁸² Considering the high risk and uncertainty involved in the high-tech industry, innovators may occasionally stake their entire personal wealth on a new idea when they are sufficiently enthusiastic about its potential, and believe that it can be highly profitable down the road. Thus, “[t]he entrepreneur’s idiosyncratic vision will often include elements that outsiders, including the firm’s minority shareholders, cannot observe or verify.”¹⁸³ Judicial review of such risk-taking innovative choices may undermine such entrepreneurship.¹⁸⁴

Another example concerns the duty of care of bank officers who are entrusted with the savings of the general public, and whose activities have an impact on the economy's overall financial stability.¹⁸⁵ The activities of banks and financial institutions involve special risks that may give rise to unique corporate

Germany, § 93(1) AktG (Germany) considers the standard of care due to be at the same time objective and relative, i.e., a company comparable in size, business, and economic situation shall serve as a model.

179. See D Gordon Smith & Darian M Ibrahim, “Law and Entrepreneurial Opportunities” (2013) 98:6 Cornell L Rev 1533 at 1541-43.

180. See Andrew Gold, “The Entrepreneurial Business Judgment Rule” in D Gordon Smith, Christine Hurt & Brian Brougham, eds, *The Handbook on Law and Entrepreneurship* (Cambridge University Press) [forthcoming in June 2022], online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3458647.

181. Zohar Goshen & Assaf Hamdani, “Corporate Control and Idiosyncratic Vision” (2016) 125:3 Yale LJ 560 at 598-99.

182. See Gold, *supra* note 180 at 9.

183. Goshen & Hamdani, *supra* note 181 at 579.

184. See Gold, *supra* note 180 at 10, citing Goshen & Hamdani, *supra* note 181 at 579.

185. See Julie Andersen Hill & Douglas K Moll, “The Duty of Care of Bank Directors and Officers” (2017) 68:4 Ala L Rev 965.

government arrangements.¹⁸⁶ The conventional view is that poorly managed financial firms can paralyze not only the firm itself, but the entire financial system, and therefore the economy as a whole.¹⁸⁷ This places unique demands on a financial institution's board of directors, tasked with establishing effective risk oversight systems within the firm.¹⁸⁸ The significant differences between the characteristics of financial corporations and non-financial corporations justify the creation of special accountability regimes for managers and directors of financial institutions that extend beyond the benefit of the corporation itself, to encompass broad public goals.¹⁸⁹ Moreover, since poor management of financial institutions may cause damage that exceeds the harm inflicted on shareholders' assets, the law must extend the obligations and duties imposed on executives and directors of such institutions.¹⁹⁰

Surprisingly, Delaware courts have adopted a different approach—one that is centered only on the consequences that the decision-making process had on the company, and whether there had been any 'red flags' that the directors should have been aware of and did not employ any remedial measures to counter.¹⁹¹ Thus, the *Caremark* ruling posits that directors are liable for a failure of board oversight only where there is "sustained or systemic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists," noting that this is a "demanding test."¹⁹² Several cases on fiduciary duties of the boards of financial institutions have extended the protection afforded to the risk oversight functions of directors.

186. See Jeremy C Kress, "Board to Death: How Busy Directors Could Cause the Next Financial Crisis" (2018) 59:3 Boston College L Rev 877 at 885.

187. *Ibid* at 888-91.

188. See OECD, *Corporate Governance: Risk Management and Corporate Governance* (OECD, 2014) at 13 ("[s]ince the beginning of the financial crisis, various surveys have revealed that corporations developing their risk management and oversight practices still face challenges, such as linking risks to strategy; better defining risks; developing corporate responses to risks that manage to address all five key dimensions (strategy, people, detail, tasks, and drivers); effectively considering stakeholders' and gatekeepers' concerns; and addressing all these issues from a whole-enterprise perspective. These challenges are faced by both financial and non-financial companies").

189. See e.g. Barnali Choudhury & Martin Petrin, *Corporate Duties to the Public* (Cambridge University Press, 2018) at 8-36.

190. See Iris H-Y Chiu, "Regulatory Duties for Directors in the Financial Service Sector and Directors' Duties in Company Law: Bifurcation and Interfaces" (2016) 6 J Bus L 465 at 465 (arguing that "directors' duties in company law serve different purposes from the regulatory regime for senior persons' conduct in the financial services sector, and hence the approach taken to separately regulate directors' conduct in financial services is a correct one").

191. See Martin Lipton et al, "Risk Management and the Board of Directors" (20 March 2018), online: *Harvard Law School Forum on Corporate Governance* <https://corpgov.law.harvard.edu/2018/03/20/risk-management-and-the-board-of-directors-5/> ("[t]hus, while it is true that the Delaware Supreme Court has not indicated a willingness to alter the strong protection afforded to directors under the business judgment rule that underpins *Caremark* and its progeny, cases such as *In re Wells Fargo* and Chief Justice Strine's dissent in *Good* should serve as reminders that board processes and decision-making may still be questioned where there are specific allegations that directors ignored 'red flags' . . .").

192. *In re Caremark International Inc Derivative Litigation*, 698 A (2d) 959 at 971 (Del Ch 1996) [*Caremark*].

For example, *In re Citigroup Inc. Shareholder Derivative Litigation*,¹⁹³ decided in 2009, the plaintiff asserted that the defendant directors of Citigroup had breached their fiduciary duties by not suitably monitoring business risks that Citigroup had incurred from subprime mortgage securities, and by ignoring specific ‘red flags’ that had been identified by press reports, revealing acute conditions in the credit markets.¹⁹⁴ The Court rejected these claims, reaffirming the “extremely high burden” plaintiffs confront in bringing a claim for personal liability for a failure to oversee business risk, and that a “sustained or systemic failure” to execute oversight is needed to confirm the absence of good faith that is a prerequisite condition for liability.¹⁹⁵

The Court failed to discuss the implications that the director liability regime has for ensuring the financial stability of the entire economy.¹⁹⁶ In particular, the Court considered the external economic conditions that the directors had to confront by focusing exclusively on the impact of such conditions on the company, without sufficiently considering the fact that the directors’ decisions also had a direct impact on the overall financial conditions of the markets as a whole.¹⁹⁷ Put differently, when considering the decision-making process of boards of financial institutions in fragile economic conditions, courts must analyze not only the implications of such a process on the company’s well-being, but also its consequences for the economy’s overall financial stability.¹⁹⁸

Interestingly, in Canada, directors of pension funds’ institutions may assume the fiduciary duties of plan administrators if the administrators have assigned them responsibility for pension oversight.¹⁹⁹ In this respect, Canadian case law has recognized that pension trustees are legally required to consider how their investment decisions will affect the stability of the financial system, and the direction of the economy.²⁰⁰ In the case of *Hodgkinson v. Simms*, for example, the Canadian Supreme Court discussed several explanations for regulating the use of fiduciary authority with regard to financial services,²⁰¹ and stressed that fiduciary obligations in this industry are designed to serve public purposes

193. 964 A (2d) 106 (Del Ch 2009) [*Citigroup*]. See also, *In re Goldman Sachs Group, Inc Shareholder Litigation*, 2011 WL 4826104 (Del Ch).

194. See *Citigroup*, *supra* note 193 at 130.

195. *Ibid* at 122-25.

196. See Franklin A. Gevurtz, “The Role of Corporate Law in Preventing a Financial Crisis: Reflections on *In re Citigroup Inc Shareholder Derivative Litigation*”, Case Comment, (2010) 23:1 Pacific McGeorge Global Business & Development Law Journal 113 at 135-48.

197. *Ibid* at 136-38. See also Claire A Hill & Brett H McDonnell, “Reconsidering Board Oversight Duties after the Financial Crisis” [2013] U Ill L Rev 859 (arguing for an expansion of board monitoring duties following the financial crisis).

198. However, since June 2019, several cases ruled by the Delaware Courts may represent a new development in relation to oversight duties (*Caremark* duties). Specifically, “[t]he courts now increasingly apply the ‘mission critical compliance’ exception to justify enhanced duties, and lower the threshold for receiving information in order to investigate potential failure-of-oversight claims.” Roy Shapira, “A New *Caremark* Era: Causes and Consequences” (2021) 98:6 Washington University Law Review 1857 at 1857.

199. See Barry Reiter, *Directors’ Duties in Canada*, 3d ed (CCH Canadian, 2006) at 270-73.

200. See Edward J Waitzer & Douglas Sarro, “The Public Fiduciary: Emerging Themes in Canadian Fiduciary Law for Pension Trustees” (2012) 91:1 Can Bar Rev 163 at 207.

201. [1994] 3 SCR 377 at 420-22. See also Waitzer & Sarro, *supra* note 200 at 171-73.

and valuable social institutions.²⁰² More interestingly—based on the view that financial fiduciaries advance unique public goals—the Court has adopted a contextual approach to analyzing when fiduciary obligations arise, and the scope of these duties in various scenarios.²⁰³

Nevertheless, even after the 2008 financial crisis, most countries have not yet developed nuanced standards of conduct for directors of financial institutions, or increased the duty of care.²⁰⁴ This duty continues to be broadly the same for directors of financial institutions and of other firms. To eliminate excessive risk-taking by directors of financial entities,²⁰⁵ corporate governance arrangements must strengthen the liability regimes of managers and directors.²⁰⁶ Redesigning the standards of care imposed on such officers, and the extent of protection offered to their decisions under the business judgment rule, may recast the ongoing debate on the responsibilities and duties of directors in various public corporations.

IV. Firm-Specific View of External Corporate Governance Regimes

In this Part, I explore external corporate governance regimes by focusing on the company goal debate. I provide a micro-level perspective for articulating the company objective that is grounded on firm-specific features.²⁰⁷ This understanding may demonstrate how this legal doctrine could be reformulated in accordance with companies' actual needs and demands.

A. Cultural Norms and the Debate Over the Company's Goal: A Theoretical Survey

Following the studies of La Porta et al. and the formation of an *antidirector index* for representing legal rules in the various legal systems,²⁰⁸ the Law Matter school has argued that Anglo-American legal systems provide extensive protection of the rights of minority shareholders compared with the weaker protection provided by Continental legal systems.²⁰⁹ Studies by Simeon Djankov et al. have also examined corporate laws of 72 countries, and confirmed that legal rules on

202. This is also expressed in s 122(1.1) of the *CBCA*, which states that “[w]hen acting with a view to the best interests of the corporation under paragraph (1)(a), the directors and officers of the corporation may consider, but are not limited to, the following factors . . . (iii) *retirees and pensioners*” [emphasis added]. *Canada Business Corporations Act*, RSC 1985, c C-44 [*CBCA*].

203. See Waitzer & Sarro, *supra* note 200 at 173-77.

204. See Steven L Schwarcz, Aleaha Jones & Jiazhen Yan, “Responsibility of Directors of Financial Institutions” in Danny Busch, Guido Ferrarini & Gerard van Solinge, eds, *Governance of Financial Institutions* (Oxford University Press, 2019) at §7.01.

205. *Ibid* at §7.03.

206. See Frank Partnoy, “Delaware and Financial Risk” in Steven Davidoff Solomon & Randall Stuart Thomas, eds, *The Corporate Contract in Changing Times: Is the Law Keeping Up?* (University of Chicago Press, 2019) 130 at 130-31.

207. See Aguilera & Jackson, *supra* note 9 at 518.

208. See Rafael La Porta et al, “Law and Finance” (1998) 106:6 *Journal of Political Economy* 1113.

209. *Ibid* at 1138-41.

shareholder protection have a measurable impact on financial development.²¹⁰ These studies have established that the quality of legal rules varied systematically with the ‘origin’ of a country’s legal system. In particular, it has been found that countries of English legal origin provided considerably better shareholder protection than those of other legal origins—especially those of Scandinavian legal origin.²¹¹ However, these studies have been faulted in several respects. First, it has been argued that the Law and Finance school is wrong in its classification method of legal systems, insofar as it is inconsistent with the prevailing understanding in the comparative legal literature.²¹²

Moreover, to better understand the distinction between the different legal traditions, it is impossible to restrict the study to the quality of legal norms on their own without examining the culture of the legal system, which is not necessarily reflected in the statutory norm.²¹³ Second, it has been claimed that for the antidirector index to reliably represent legal rules in different legal systems, data coding must be transparent, consistent, and accurate.²¹⁴ Thus, subsequent studies that sought to reconstruct the findings of the Law and Finance school using more advanced statistical methods, did not find that Anglo-American legal systems necessarily provide better protection to minority shareholders’ rights than Continental legal systems, or that the scope of protection of minority shareholders makes it possible to predict market size, stock allocation, or economic growth.²¹⁵

However, the legal origin perspective would be considered to be only a limited description of corporate governance systems if it did not also combine the complementary role of the cultural environment of those systems.²¹⁶ Culture, as an open system, can address corporate governance issues that are likely to be regulated by the state.²¹⁷ Several studies have found that national corporate practices—such as accounting information disclosure, self-dealing, insider trading, and executive pay—are a function of cultural and historical orientations that are rooted in all societies.²¹⁸ Accordingly, culture, as a set of informal

210. See Simeon Djankov et al, “The law and economics of self-dealing” (2008) 88:3 *Journal of Financial Economics* 430; Rafael La Porta, Florencio Lopez-de-Silanes & Andrew Shleifer, “The Economic Consequences of Legal Origins” (2008) 46:2 *Journal of Economic Literature* 285.

211. See Mathias M Siems, “Taxonomies and Leximetrics” in Jeffrey N Gordon & Wolf-Georg Ringe, eds, *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press, 2018) 228 at 234.

212. See Gerhard Schnyder, Mathias Siems & Ruth V Aguilera, “Twenty Years of ‘Law and Finance’: Time to Take Law Seriously” (2021) 19:1 *Socio-Economic Review* 377 at 389-92.

213. See Siems, *supra* note 211 at 238-42.

214. See Holger Spamann, “The ‘Antidirector Rights Index’ Revisited” (2010) 23:2 *The Review of Financial Studies* 467 at 470-72.

215. *Ibid* at 467 (finding that “a thorough reexamination of the legal data, however, leads to corrections for thirty-three of the forty-six countries analyzed” and “many empirical results established using the original index may not be replicable with corrected values”).

216. See Licht, *supra* note 114 at 138-39.

217. *Ibid* at 138 (“[a] key insight here is that culture, as an informal institution, can address the very issues that governance, including corporate governance, calls for regulating”).

218. See Amir N Licht, Chanan Goldschmidt & Shalom H Schwartz, “Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance” (2007) 35:4 *Journal of*

institutions, may affect diversity in corporate governance by supporting, constraining, or substituting the formal legal institutions.²¹⁹

One prominent example of the interaction between formal and informal social norms is evident in the dispute over the corporation's primary objective.²²⁰ The Anglo-American view posits that public companies have a general duty to maximize the wealth of their shareholders.²²¹ Since maximizing shareholder value is the only goal that companies must advance, considering the interests of other stakeholders is made instrumentally for the promotion of shareholders' long-term interests alone.²²² In contrast, the civil legal system view is that focusing solely on increasing shareholder wealth may be directly detrimental to other stakeholders—such as employees, creditors, consumers, and suppliers—and consequently to the company itself.²²³ Accordingly, the board of directors' role is to coordinate the activities of all constituents who contribute to corporate production.²²⁴ In Germany, the stakeholders' governance view provides the employees with a significant role in advancing adequate and proper corporate governance practices.²²⁵ Its *codetermination model* promotes a democratic decision-making process by assigning similar weight to the financial and human-capital contribution to the company's business.²²⁶

Recently, Licht and Adams presented evidence on how personal and institutional factors collectively guide public company directors when exercising discretion in situations involving shareholder-stakeholder tensions.²²⁷ In a sample of

Comparative Economics 659 (explaining governance practices differences across 50 countries with regard to three basic social norms: the rule of law, corruption, and democratic accountability).

219. See Aguilera & Jackson, *supra* note 9 at 503.

220. *Ibid.*

221. See *Dodge v Ford Motor Co*, 170 NW 668 (Mich 1919); *eBay Domestic Holdings, Inc v Newmark*, 16 A (3d) 1 at 15-16 (Del Ch 2010); Lucian A Bebchuk & Roberto Tallarita, "The Illusory Promise of Stakeholder Governance" (2020) 106:1 Cornell L Rev 91 (arguing that stakeholderism may inflict substantial costs on shareholders, stakeholders, and society, and reduce corporate leaders' accountability).

222. However, see Tamara Belinfanti & Lynn Stout, "Contested Visions: The Value of Systems Theory for Corporate Law" (2017) 166:3 U Pa L Rev 579 at 596-98 (under uncertainty there is no objective assessment mechanism to explain the company's long-term goals).

223. See Cynthia A Williams, "Corporate Social Responsibility and Corporate Governance" in Gordon & Ringe, *supra* note 211 at 634.

224. See Margaret M Blair & Lynn A Stout, "A Team Production Theory of Corporate Law" (1999) 85:2 Va L Rev 247 at 260.

225. §§ 93(1)-93(2) AktG (Germany).

226. An intermediate model that has been adopted in UK is the enlightened shareholders value. See *Companies Act 2006* (UK), s 172. For a similar view in Canada, see *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 40 ("[i]n considering what is in the best interests of the corporation, directors may look to the interests of, inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions"); CBCA, s 122(1). Nevertheless, recent empirical study suggests that the move from shareholder primacy to a stakeholder regime did not appear to produce significant impacts on litigation patterns, takeover premiums, equity asset values, and equity risk premiums. See Bryce C Tingle & Eldon Spackman, "Do Corporate Fiduciary Duties Matter?" (2019) 4:4 *Annals of Corporate Governance* 272.

227. See Amir N Licht & Renée B Adams, "Shareholders and Stakeholders Around the World: The Role of Values, Culture, and Law in Directors' Decisions" (2019) *European Corporate*

more than nine hundred directors from over fifty countries of origin, they confirm that directors universally hold a principled, quasi-ideological stance toward shareholders and stakeholders, called *shareholderism*. Moreover, they found that directors' shareholding correlates systematically not only with their personal values, but also with cultural norms that are consistent with entrepreneurship. Moreover, those informal norms appear to dominate the legal rules that shape directors' shareholding stances.²²⁸ Thus, irrespective of how the law might determine the corporation's objectives, board members may adopt strategies that deviate from that rule, and act according to their own values.²²⁹ The broader implication of Licht and Adams's study is that firm-specific features are the ones that govern corporate decision-making, and any legal construction of the company's objective should at least be sensitive to firm-specific circumstances as a guidance for insiders' conduct.

B. Firm-Specific View of the Company's Goal Debate

The company's business activities are generally based on the contribution of different stakeholders. For instance, while shareholders and creditors contribute financial capital to the company's business, managers, directors, and employees provide human capital, and suppliers offer the physical capital necessary to its ongoing function. Recently, Belinfanti and Stout argued that the law should not confine the company's activity to the fulfillment of merely one single objective, which is the promotion of shareholders wealth.²³⁰ Often, the interests that the company seeks to achieve have a powerful interaction between them, so the law should avoid subordination of one goal to another.²³¹

In general, legal systems assume that a company should pursue a single goal that fits all kinds of corporations in the market.²³² However, the firm-specific strategy rejects this assumption. Due to profound differences in the features of companies, including their assets, the holdings of their capital share, the human capital diversification, and their dependency on the contribution of specific stakeholders, the law should refrain from articulating one single objective which suits all corporations.

The firm-specific view posits the structure, functions, and activities of the company should not be confined for increasing shareholders or stakeholders' value as such but instead for *promoting the separate and special interests of*

Governance Institute—Law Working Paper No 459/2019, online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3407873.

228. *Ibid* at 2.

229. *Ibid* at 19.

230. See Belinfanti & Stout, *supra* note 222 at 600.

231. *Ibid* at 605-11.

232. See also Edward B Rock, "For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose" (2020) European Corporate Governance Institute—Law Working Paper No 515/2020 at 20, online: <https://ssrn.com/abstract=3589951> ("[a]s the debate over the right balance of power between shareholders and managers continues . . . there are reasons to think that no single strategy will be best for all firms") [emphasis added].

the firm to increase its *own* value and performance.²³³ According to the firm-specific view, the interests of shareholders or stakeholders could be considered only if they correspond to the company's sole interests. For instance, we can assume that a company whose principal activity is limited to the holding of several other companies has a remarkably different purpose to achieve than a company whose main production activity is highly dependent on the capital contribution of employees, creditors, and consumers.

To illustrate this idea, consider the example of dividend distribution. One of the central functions of any legal capital regime is to ensure that the creditors have preferential access to the company's assets by restraining the company's ability to make distributions to the shareholders.²³⁴ From a stakeholders' perspective, any distribution decreases the available assets they could reach for paying the company's debts and thus it should be carried out only in special circumstances. This is especially true in certain industries that experience financial distress because of the pandemic and in which companies have to ensure their survival. Stakeholders who consider the company's distribution policy to be an excessive one may refrain from providing resources required for increasing firm value. At the same time, because stockholders perceive dividend distribution to be an integral part of earning a return for their investment, a company that generally refrains from distributing profits will experience difficulties in raising equity in the stock markets.²³⁵ Therefore, the balance between shareholders' and stakeholders' interests should be carried out from the perspective of the firm itself. The company has to balance the costs associated with the loss of stakeholder resources contributions because of an announced distribution and the expected increase of its capacity to raise valuable (and cheap) equity in capital markets. Consequently, the company should distribute dividends only when it considers the benefits involved to outweigh the costs imposed on the firm.²³⁶

Furthermore, provided that the interests that should be considered are those of the company itself as distinct from any other stakeholder or stockholder, the goal that a company advances cannot remain constant throughout its lifecycle. Because companies' business activities are subject to change over time, the objective that a company's organs pursue may also change, in line with its

233. This idea follows the research of Andrew Keay, "Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model" (2008) 71:5 Mod L Rev 663, and the research of Yedidia Stern, *Corporate Goals* (Bar-Ilan University Press, 2007) [in Hebrew], who argued that considering the interests of the various constituencies has a purely instrumental nature for increasing the sole value and profits of the *company* as an independent and separate entity without any legal owners.

234. See Beuerle & Schillig, *supra* note 36 at 761.

235. Shareholders only hold expectations of receiving dividends in the case of successful business outcomes rather than established and protected rights. See Paul Davies QC, *Introduction to Company Law*, 3d ed (Oxford University Press, 2020) at 13 ("[s]hareholders obtain shares initially in the company in exchange for a contribution of value to the company; usually, but not necessarily, a contribution of cash. As a first step towards the provision of risk capital, company law does not require those shares to carry any legal entitlement to a return on the investment; for example, by way of a dividend the company is obliged to pay").

236. This example is based on Yedidia Stern, "The Goal of the Business Corporations: Interpretation and Practical Implications" (2001) 32:2 Mishpatim 327 at 346 [in Hebrew].

business results and the respective contributions of various stakeholders to the company's welfare. For example, one might argue that the purpose of a company immediately after its founding is significantly different from its objective long after its incorporation. This is because immediately after the incorporation of the company, it is highly dependent on capital investment to facilitate its initial operations. This is especially true when the company's activities are conducted in markets with high barriers to entry. Therefore, at the startup stage, the law should construct the company's goal solely in line with the interests of shareholders and creditors, who provide the initial capital it needs to start its operations. However, once the company's business operations are established and recognized, the law should apply corporate governance rules to protect the interests of other stakeholders as well.

V. Further Challenges

The implementation of the firm-specific model requires addressing several challenges.

A. Toward Optimal Standardization of Corporate Law

Our model is based on formulating a corporate governance eco-system in terms of complexity, which is the result of the interactions between individual governance regimes. To be attentive to the wide-ranging values of the system, courts must produce governance arrangements that are sensitive to the special features of firms and industries. Recently, Henry E. Smith has also perceived private law in terms of complexity, though, following Herbert Simon's writings, he understands it to be "nearly decomposable."²³⁷ Smith advances the idea of modularity as a mechanism to handle private law's complexity that "permits complex behavior at lower cost,"²³⁸ and allows one to "model the law without prejudging the degree of system."²³⁹

One can argue that our thesis calls the courts to produce *fully* customized governance arrangements on a case-by-case basis, thereby implying that corporate law should be seen as totally chaotic. Although courts should acknowledge the unique features of companies, industries, and markets in creating governance regimes, their discretion on how to do so is not unlimited. I provided specific criteria for formulating firm-specific power relations between insiders and outsiders that *equally* apply to a broad range of corporate disputes. Put differently, while I urge the courts to consider heterogeneity concerns, they are still required to strictly use detailed rules that provide enough simplicity and modularity, which "lead to improvement toward a local optimum."²⁴⁰ By creating a broader set of

237. Herbert A Simon, *The Sciences of the Artificial*, 2d ed (MIT Press, 1981) at 197.

238. Henry E Smith, "Systems Theory: Emergent Private Law" in Andrew Gold et al, eds, *The Oxford Handbook of New Private Law* (Oxford University Press, 2021) 143 at 148.

239. *Ibid* at 148-49.

240. *Ibid*.

corporate governance regimes, the law can address variations among shareholders, transactions, corporations, and the unique market-based concerns, thereby producing ‘optimal standardization’ of corporate law.²⁴¹ Moreover, the legal community can anticipate that large normative categories that address firms’ shared characteristics relating to firm-specific power relations, industry, and market conditions will eventually emerge as part of the case law development. These categories will reduce the costs firms will have to bear in figuring out the future courts’ rulings. Therefore, the model presented in this paper does *not* suggest that corporate governance regimes are *maximally* connected in the sense that no substantive rules could provide explanation and legitimacy to the system, and *fully* firm-specific rules are in order.

B. Mitigating Delineation and Information Costs

According to this challenge, the firm-specific model (as opposed to a one-size-fits-all approach) increases courts’ delineation costs in observing the actual power relations between controlling and minority shareholders or between shareholders and management, and raises the information costs for insiders and stakeholders when they consider interacting with the company.²⁴² Certain aspects of the theoretical model, such as the relative ratio of holdings between shareholders and the industries in which companies operate, do not necessarily involve an increase in information and delineation costs because the required data on these aspects—and their commercial practices implications—are freely available to all players in the market. However, investigating the existence of an effective oppositional alliance that could undermine insiders’ control could carry out costs that have to be addressed.

First, because there is a clear connection between the size of shareholdings and the ability to create an effective oppositional alliance of outsiders, the available data in the market could assist in mitigating these costs.

Second, major changes in the size of shareholdings that affect the chances of creating an oppositional alliance of minority shareholders—and as a result alter the internal power relations—do not occur frequently, but rather occur mainly under influential developments and circumstances in the company’s business condition that alter its size and scope of operations. In these settings, any stakeholder who considers interacting with the company carries out comprehensive inquiries anyway.

Third, even if the delineation and information costs involved are substantial, they are generally reduced as the result of proxy advisors’ activities. Because

241. The term ‘optimal standardization’ is borrowed from Thomas W Merrill & Henry E Smith, “Optimal Standardization in the Law of Property: The *Numerus Clausus* Principle” (2000) 110:1 Yale LJ 1.

242. See Andrew S Gold & Henry E Smith, “Sizing Up Private Law” (2020) 70:4 UTLJ 489 at 501 (“[i]ndeed, the very issue of complexity points to an important and often overlooked functional consideration: information costs. Methods of managing complexity through modularity allow the legal system to organize around clusters of interactions”).

governance conflicts are generally addressed by proxy advisors—who provide recommendations to institutional investors on how to cast votes at shareholder general meetings—they convey their assessment on who should be considered the company’s controller and whether there is an effective oppositional alliance of minority shareholders in the firm. Their detailed recommendations have the potential to reduce the costs that any stakeholders or stockholder will have to bear if they want to interact with the company.

VI. Conclusion

This Essay was devoted to exploring two main forms of pluralism, namely the plurality of corporate law’s sources and the plurality of corporate law’s values. These fundamental parts of corporate law pluralism indicate that courts should embrace rules that consider the specific actual interactions within and among business organizations, so the general normative arrangements are closely aligned with the factual characteristics. Accordingly, the effectiveness of a corporate governance ecosystem depends on considering the effect of the heterogeneous nature of its participants and the firm-specific power relations, in the design of internal and external governance arrangements. Moreover, by assigning the court the role of assessing firm-specific power relations and their implications for regulatory design, the court ‘mimics’ the governance arrangements that the parties would have chosen for themselves ex-ante if they could anticipate future disputes and business contingencies. Thus, rather than speaking about the common law of corporations generally, we should focus on the law as it pertains to individual companies. While this Essay was devoted to the theoretical construction of pluralist understating of corporate law, future empirical work has to be done to examine the effectiveness of such regimes in directing insiders’ conduct and increasing corporate value and performance in practice.

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