

# **The Simplification of the Criteria for Good Corporate Law or Why Corporate Law Is Not As Important Anymore**

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The criteria found in Bill Klein's *Criteria for Good Laws of Business Association*<sup>1</sup> are not criteria for good corporate scholarship. Much corporate scholarship does make proposals for making corporate law better, and the criteria are offered to encourage authors to be more explicit about the assumptions that undergird their arguments for the proposals they advance. However, there is much corporate scholarship that is not normative in its orientation: scholarship that describes regularities in the structure of corporate law or scholarship that tests theories against empirical information. The Criteria Project is aimed at only one part of the world of corporate scholarship.

The goals of corporate law are much easier to describe today than they were even twenty and certainly a hundred years ago. Corporate law has come to be understood as a system of multi-party contractual relationships, a subpart of contract law. Corporate law provides default rules that can be varied by the parties. The law is concerned with implementing the agreement that the parties have made. Purchasers of securities issued by corporations are presumed to be bound by the terms of the securities they have purchased, even if those terms are exceedingly complex and technical. The law has shifted from a concept of mandatory corporate norms to a concept of a set of organizational options. Not only can the organic documents of an entity be customized, but there is now a menu of available organizational forms—the business corporation, the limited liability company, the limited liability partnership, the limited partnership—combined with a wide range of jurisdictional options—Delaware, Nevada, Maryland, New York, California—from which the parties can choose.

Corporate law did not start this way. Corporations began as special purpose entities created by the sovereign to achieve specific public purposes. Each charter was tailored to meet the objectives of the government creating the entity. The provisions of these charters addressed issues that we today would classify as part of tax law, antitrust law, securities law, labor law, or industrial

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1. 2 BERKELEY BUS. L.J. 13 (2005).

regulation. The jurisprudential world view in the United States in the first half of the nineteenth century was that individual citizens could not be subject to restraints on their economic liberty but that the corporation—a creation of the state—could. In this environment, there were no general systems of regulation applicable to all who engaged in a particular activity, but there were detailed restrictions in corporate charters.

The transition to contemporary sensibility, which assumes that substantive regulation should be imposed on all entities that engage in an activity—whether they be an individual, a partnership, a business corporation, an LLC or whatever—and that the choice of business form should not affect the applicable regulatory rules, was long and confused. The critical moment was the introduction of general incorporation statutes that made the grant of the corporate charter automatic once the prescribed mechanical steps were taken. Once the state no longer seriously undertook the task of imposing customized restrictions on each corporation based on its particular situation, it became difficult to hold the view that such restrictions served important state policies. But the understanding of that implication of the general incorporation laws took more than a century to emerge as a consensus.

The contemporary sensibility has made the task of identifying the criteria for good corporate laws much easier than it once was. That development explains, for instance, the notable convergence of U.S. corporate laws. Many of the issues that Professor Klein raises are important issues that need to be addressed by law, but a contemporary lawyer would not think to address them in corporate statutory or decisional law. Antitrust law and political campaign legislation address the issues of corporate size and corporate power. Labor law addresses the relationship between employers and employees. Tax law addresses the issues of wealth redistribution. Securities law addresses the issues of the relationship between the issuer and public investors.

Although there is a consensus, its influence on the law is not complete. For instance, it seems likely that the issue of whether it is possible by a provision in an organic corporate document to move enforcement of its provisions from the courts to an arbitration procedure will be contested in the decades ahead.<sup>2</sup> And securities regulation, which in its application to corporate issuers can be viewed as part of corporate law, and which is mandatory and not consensual in structure, is an area where the contractual approach is in dispute in the literature. Roberta Romano has advanced the idea that the contractual choice approach should be extended to securities regulation by amending the securities statutes so that corporate issuers could choose whether to be subject to their

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2. In *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999), the Delaware Supreme Court held that a LLC operating agreement can provide for the resolution of disputes among the members by arbitration.

requirements.<sup>3</sup> Purchasers who wished to buy securities subject to the securities laws could buy the securities of issuers who had elected coverage; purchasers who did not could buy the securities of issuers who had elected not to be subject to the securities laws.

In *Proposals for Reform of Securities Regulation*,<sup>4</sup> I argued that the Romano proposal is less radical than it appears because of the influence the contractual idea already has had on securities regulation. For instance, issuers can choose to sell securities under the provisions of the 1933 Securities Act, or they can choose to sell them outside the provisions of the Act by following the procedures for a private placement.

The argument for issuer and purchaser choice is that purchasers are just as capable of judging the information disclosure and liability regime that they prefer to govern the securities they purchase as they are able to judge the terms of the security, or to make judgments about the economic future of the issuer. At present, we permit purchasers to decide, for instance, whether to buy a tracking stock even though evaluation of a tracking stock requires a sophisticated understanding of the terms of the security, the practices of accounting, and the effects of conflicts of interest. We permit purchasers to decide, for instance, to purchase common stock issued by a pharmaceutical company, even though evaluation of the economic future of a pharmaceutical company requires a sophisticated understanding of pharmacology, double blind studies, chemistry, disease, and medical practice. Why are not the same purchasers allowed to judge whether they wish to purchase securities whose features include that they conform to the requirements of and are subject to the liabilities imposed by the securities laws?

Romano's proposal has had a dramatic impact on the structure of the scholarly dialogue about securities regulation. The securities statutes were once justified on the ground that they protected investors, whether or not they wanted the protection. Now, a new justification is offered. Securities statutes are needed to make economically relevant information available to economic decision makers, because having such economically relevant information increases the overall efficiency of the economy.<sup>5</sup>

In *The Theory and Practice of Securities Disclosure*,<sup>6</sup> I examined the question whether the securities laws as actually administered do force the disclosure of all material and relevant economic information necessary to either

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3. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

4. See Edmund W. Kitch, *Proposals for Reform of Securities Regulation: An Overview*, 41 VA. J. INT'L L. 629, 645-48 (2001).

5. Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997).

6. Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763 (1995), reprinted in 29 SEC. L. REV. 3 (1997).

price securities in a correct manner, or more ambitiously, to make the entire economy more efficient. I argued that an examination of the actual information, the disclosure of which is required by the securities laws, shows that a great deal of economically relevant and important information is not disclosed, and I speculated why that might be the case.

The emergence of a contractarian consensus in corporate law has simplified the field. At the same time, it has reduced the importance of the field, for the consensus of necessity concedes that public policy questions such as concentration of power, structure of the tax system, employer-employee relations, and organization of the securities markets are appropriate subjects for the law to address. The only claim of the contractarian consensus is that those subjects should be addressed in other fields of law, not as part of the law governing the internal structure of the firm. As a result, the field of corporate law has lost some of its importance.