

CORPORATE GOVERNANCE:  
CURRENT TRENDS AND LIKELY DEVELOPMENTS FOR  
THE TWENTY-FIRST CENTURY

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ABSTRACT

*This article discusses current trends in corporate governance and theorizes on the likely impact of those trends for the twenty-first century. Part II focuses on an overview of four current trends in the areas of technology, globalization, shareholder activism, and private ordering. Part III assesses the likely impact of those trends on corporate governance in the twenty-first century. A successful corporation will need to seamlessly integrate technology to act effortlessly across international time zones, and it will need to raise capital quickly and efficiently in different global capital markets. The authors posit that these needs will lead to the emergence of a universal entity, affording its creators maximum flexibility.*

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## I. INTRODUCTION

One hundred years ago, cars, televisions and computers did not exist; women could not vote; and most people thought nothing about waiting a month, or more, to receive their mail. Today, the Concord can make a Trans-Atlantic flight in less than three hours; women hold two out of the nine seats on the U.S. Supreme Court; and fax machines and E-mail have made waiting overnight for Federal Express seem inefficient. Given how far we have come this century, one cannot help but wonder just what Y<sup>21</sup>K problem businesses will be grappling with 100 years from now.

This article surveys current trends in corporate governance and theorizes on the likely impact of those trends for the twenty-first century. Specifically, Part II provides an overview of four current trends that are changing the way corporations do business. First, technology is reshaping the way companies raise capital, interact with suppliers and customers, and relate to investors. Second, the globalization of the economy is making the world a much smaller place, and nationalism is giving way to

interdependence and economic efficiencies. Third, shareholders are taking a more active monitoring role and are seeking creative ways to hold management accountable. Fourth, corporate promoters are eschewing traditional corporate forms in favor of those providing the maximum potential for private ordering.

Part III assesses the likely impact these four trends will have on corporate governance in the twenty-first century. A successful corporation, for example, will need to seamlessly integrate technology into all aspects of its business. It will need to be able to act, and react, effortlessly across international time zones and boundaries. In addition, it will need to raise capital quickly and efficiently in dramatically different global capital markets. The authors surmise that these needs will lead to the emergence of a universal entity, one affording its creators maximum flexibility through private ordering. The entity will be simple in form, structure all stakeholder relationships in advance through contract, and cross international boundaries. The jurisdiction that is able to develop, structure, and support such a universal entity will not only be a national leader in corporate governance, but will be an international one.

## II. CURRENT TRENDS

### A. *Technology*

The personal computer is revolutionizing the American household. Approximately forty-three percent of American households had personal computers at the beginning of 1998. It is expected that that number will jump to sixty percent by the year 2002.<sup>2</sup> America Online increased its subscription from 1.5 million in January 1995 to 3 million in July 1995 to 11 million by March 1998.<sup>3</sup> E-mail usage now far surpasses the use of first class mail. The number of E-mails in the U.S. surged to nearly four trillion messages in 1998, compared to only 107 billion pieces of first-class mail delivered by the U.S. Postal Service. Family members are using home computers for everything from doing homework, to balancing checkbooks, to shopping, to corresponding with friends and relatives, to tele-commuting.<sup>4</sup>

Technology is also transforming the way American corporations are doing business. Specifically, companies are raising capital, interacting with

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<sup>2</sup>See Peter Burrows, et al., *News; Analysis & Commentary, Cheap PCS*, BUS. WK., Mar. 23, 1998, at 28.

<sup>3</sup>See Daniel Everett Giddings, *An Innovative Link Between the Internet, the Capital Markets, and the SEC: How the Internet Direct Public Offering Helps Small Companies Looking to Raise Capital*, 25 PEPP. L. REV. 785, 797 (1998).

<sup>4</sup>See *id.* at 798.

customers and suppliers, and communicating with shareholders in ways that were not thought possible just twenty-five years ago.<sup>5</sup>

## 1. Raising Capital

Technology and the capital markets have a symbiotic relationship. As described below, the efficient deployment of capital has helped fund emerging technologies, while emerging technologies have significantly facilitated the capital markets.

### a. *Capital Markets Funding Technology*

There has been unprecedented growth in the U.S. economy over the past several years, exemplified by Dow Jones Industrial Average recently hitting an all-time high of over 11,000. In a recent speech before Congress, Alan Greenspan, Chairman of the Federal Reserve Board, explained that much of the success can be attributed to two things: "creative destruction" and open global trading.<sup>6</sup> He explained the former as follows:

It is important not to undermine the highly sensitive ongoing process of reallocation of capital from less to more productive uses. For productivity and standards of living to grow, not only must capital raised in markets be allocated efficiently, but internal cash flow, including the depreciation charges from the existing capital stock, must be continuously directed to their most profitable uses. It is this continuous churning, this so-called creative destruction, that has become so essential to the effective deployment of advanced technologies by this country over recent decades.<sup>7</sup>

But, according to Greenspan, creative destruction can only be effective in a truly global economy:

[A] drift toward protectionist trade policies, which are always so difficult to reverse, is a much greater threat than is generally understood. It is well known that erecting barriers to the free flow of goods and services across national borders undermines

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<sup>5</sup>See generally *id.* (describing the facilitation of business through new technology).

<sup>6</sup>See generally Alan Greenspan, *Statements to the Congress*, 85 FED. RESERVE BULLETIN 187 (Mar. 1999) (discussing the U.S. economy policies).

<sup>7</sup>*Id.*

the division of labor and standards of living by impeding the adjustment of the capital stock to its most productive uses.<sup>8</sup>

Accordingly, success in the future will require the continued flow of capital to productive resources, such as emerging technologies and a continued opening, even expansion, of global trading.

b. *Technology Facilitating Capital Markets*

While the markets fund technology, technology is providing unparalleled access to the markets. Small companies looking to raise capital without the prohibitive costs of using venture capital or investment banks have found a tremendous ally in the Internet. Spring Street Brewing Company, for example, was a pioneer in February 1996 with the first ever direct initial public offering (DPO) over the Internet.<sup>9</sup> The microbrewery sold 900,000 shares and raised \$1.6 million.<sup>10</sup> Blue Fish Clothing, a maker of hand-dyed garments sold at Neiman Marcus and other high-end retailers, publicized its DPO on its sales tags.<sup>11</sup> It raised \$3.9 million from mid-November 1995, to mid-May 1996, by selling \$5 shares in minimum blocks of 100 shares.<sup>12</sup> According to Blue Fish founder Jennifer Barclay, "We were hungry for cash, . . . [b]ut we only wanted to offer shares to people who understood what our company is all about."<sup>13</sup>

At least thirty-five Internet DPOs had been completed as of January 1997.<sup>14</sup> During the first nine months of 1998, 232 companies registered for DPOs, many to be sold over the Internet.<sup>15</sup> While over \$120 million was raised through Internet DPOs in 1996,<sup>16</sup> that number reportedly topped \$1 billion in 1997.<sup>17</sup>

The cost savings of an Internet DPO are tremendous.<sup>18</sup> "[C]utting out the underwriter, accountants, printing, and 'roadshows' allows companies to

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<sup>8</sup>*Id.*

<sup>9</sup>See Kerry Hannon, *Going Public to the Public, Small Businesses Can Bypass Underwriters and Save Big Money*, U.S. NEWS & WORLD REP., June 17, 1996, at 74; Giddings, *supra* note 2, at 786.

<sup>10</sup>See Giddings, *supra* note 2, at 786; Hannon, *supra* note 8, at 74.

<sup>11</sup>See Hannon, *supra* note 8, at 74.

<sup>12</sup>See *id.* at 74.

<sup>13</sup>*Id.*

<sup>14</sup>See Giddings, *supra* note 2, at 787.

<sup>15</sup>See Robert Frick, *What Not to Buy Just Yet — IPOs on the Internet*, KIPLINGER'S PERSONAL FIN. MAG., Mar. 1, 1999, at \*36.

<sup>16</sup>See Giddings, *supra* note 2, at 812.

<sup>17</sup>See P. Mitchell Woolery, *On Law*, KAN. CITY BUS. J., Oct. 23, 1998.

<sup>18</sup>See Giddings, *supra* note 2, at 794.

go public at a cost of 6% percent of the total value of the issue, as opposed to a 13% average for a traditionally underwritten offering."<sup>19</sup> Thus, the Internet has become the pathway to financing what might not otherwise be available and is giving entrepreneurs a way to avoid losing control to venture capitalists.<sup>20</sup>

The SEC has given limited and cautious approval to certain types of passive Internet marketplaces, such as bulletin boards, that allow liquidity to investors.<sup>21</sup> For example, shortly after Spring Street Brewery's Internet DPO in early 1996, the SEC gave the microbrewery the "go-ahead" to operate a permanent trading site for its stock on its web page.<sup>22</sup> The company has since gone even further by starting another Web site, named Wit Capital.<sup>23</sup> Wit Capital describes itself as "the world's first online investment banking firm" with a mission "to empower investors and issuers alike by transforming the capital raising process through the use of the Internet."<sup>24</sup>

Still, Internet DPOs are not without their detractors who point to the high risk in making investments on-line with companies too small to be able to afford an investment banker.<sup>25</sup> The heyday of the Internet DPO market is expected to be years down the road. "One study predicts that the DPO market [will not] flourish until 2005."<sup>26</sup>

## 2. Electronic Commerce

Emerging technology has caused an explosion in on-line electronic commerce. According to Forester Research, the total value of goods and services to be traded between companies over the Internet will hit \$327 billion by the year 2020.<sup>27</sup> FedEx's electronic commerce "is expected to rise 300 per cent to more than . . . \$7 billion" for fiscal year 1999.<sup>28</sup> Mammoth companies, however, are not the only ones benefiting. The Internet has

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<sup>19</sup>*Id.*; John Welbes, *West Columbia, S.C. — Based KryoTech Plans Stock Sale*, KNIGHT-RIDDER TRIB. BUS. NEWS, Apr. 2, 1999 (stating that Internet DPOs allow a company to save the six to seven percent fee that underwriters typically charge).

<sup>20</sup>*See* Giddings, *supra* note 2, at 794; Welbes, *supra* note 18.

<sup>21</sup>*See* Woolery, *supra* note 16.

<sup>22</sup>*See* Hannon, *supra* note 8, at 74.

<sup>23</sup>Wit Capital: Access Creates Opportunity (visited Jan. 24, 2000) <<http://www.witcapital.com>>.

<sup>24</sup>*Id.*

<sup>25</sup>*See* Frick, *supra* note 14, at 36.

<sup>26</sup>*Id.*

<sup>27</sup>*See* Anna Chidambar, *Modern Era Transportation*, MALAYSIAN BUS., Mar. 16, 1999, at 20.

<sup>28</sup>*See id.*

enabled a new breed of global entrepreneurs to explode into the marketplace. Small companies from emerging and lesser developed markets have become active players in the global economy, because the Internet has eliminated traditional barriers of size, capital, and national origin.<sup>29</sup> Of the estimated 2.5 million U.S. small businesses that have some form of Internet access, 900,000 have Web sites; and half of those are transacting sales on-line with businesses or consumers.<sup>30</sup>

Electronic commerce, however, is not just about selling to consumers.<sup>31</sup> "The Internet is allowing companies to link their distribution and supply channels into unified electronic networks."<sup>32</sup> Indeed, large companies and government agencies are telling suppliers to trade with them on-line or risk losing their business.<sup>33</sup> Smaller suppliers that cannot afford a complete conversion to electronic trading systems, such as electronic data interchange (EDI), are turning to intermediaries that act as electronic go-betweens.<sup>34</sup> "Business-to-business e-commerce makes up the largest portion of Internet commerce, with sales totaling \$8 billion in 1997 . . . ."<sup>35</sup> One research firm estimates that that number could grow to \$171 billion by the turn of the century.<sup>36</sup>

### 3. Investor Relations

More and more corporations are taking advantage of widespread access to, and use of, the Internet, because of its improved security, and the tremendous cost-savings of Internet publishing to improve investor relations. For example, technology-savvy companies are allowing investors to receive documents electronically, designate proxy voting instructions on-line, view annual stockholder meetings on-line; and, as discussed in Part II.A.1.b above, make investments on-line.

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<sup>29</sup>Shaker A. Zahra, *The Changing Rules of Global Competitiveness in the 21<sup>st</sup> Century*, ACAD. MGMT. EXEC., Feb. 1, 1999.

<sup>30</sup>Tim McCollum, *E-Commerce Takes Off*, NATION'S BUS., Oct. 1998, at 34.

<sup>31</sup>*See id.*

<sup>32</sup>*Id.*

<sup>33</sup>*See id.*

<sup>34</sup>*See* McCollum, *supra* note 29, at 34.

<sup>35</sup>*Id.*

<sup>36</sup>*See id.* (referring to the Yankee Group in Boston).

a. *Securities Exchange Commission Rules on Publication*

The chairman of the Securities Exchange Commission (SEC), Arthur Levitt, recently described the importance of the law keeping pace with the needs of the market:

American investors deserve a market in which the theory of the regulator matches the reality of the regulated; in which the media anticipated by the law are the same media used in real life; in which there is no gap between the way the SEC allows investors to receive information, and the way in which investors actually do receive information. . . . [W]e will keep this debate moving forward in the weeks and months ahead — until the theory of disclosure matches the realities of the marketplace in the age of information.<sup>37</sup>

The SEC has taken important first steps towards this goal by allowing electronic delivery of information to investors.<sup>38</sup> In October 1995, the SEC published Release No. 33-7233, which described when an electronic delivery format can be used, as well as the different implications of using electronic, as opposed to paper versions, of documents.<sup>39</sup>

The SEC's rules on electronic delivery basically fall into four categories. First, there must be a way to ensure that the investor is notified that the data has been sent electronically or can be read on the Web.<sup>40</sup> A company must make efforts to ensure that shareholders receive adequate notice of electronic delivery.<sup>41</sup> For example, merely posting a document to a Web page would not fulfill the notice requirement. On the other hand, a notice through the U.S. mail that a document may be viewed at a Web page could be satisfactory.<sup>42</sup> In addition, providing the electronic document itself by computer disk, CD-ROM, or E-mail is also sufficient notice.<sup>43</sup>

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<sup>37</sup>Giddings, *supra* note 2, at 806 (quoting SEC Chairman Arthur Levitt, Corporate Finance in the Information Age, Remarks Before the Securities Regulation Institute (Jan. 23, 1997) (transcript available at <<http://www.sec.gov/news/speeches/spch135.txt>>)).

<sup>38</sup>*See id.* at 804.

<sup>39</sup>*See generally* S.E.C. Release No. 33-7233, Oct. 6, 1995, *available in* 1995 SEC LEXIS 2662 (recognizing that technology allows companies to disseminate information faster and cheaper than before).

<sup>40</sup>S.E.C. Release No. 33-7288, May 9, 1996, *available in* 1996 SEC LEXIS 1299, at \*17.

<sup>41</sup>*See id.*

<sup>42</sup>*See id.*

<sup>43</sup>*See id.*



Second, the issuer must make sure that the investor has access to the Web or E-mail.<sup>44</sup> The company must provide access to the information comparable to paper delivery through the U.S. mail, and the method of access cannot be overly burdensome.<sup>45</sup> The stockholder must also have a method of retaining the accessed information, such as downloading a document onto a personal computer.<sup>46</sup>

Third, the investor must be entitled to request and receive a paper copy.<sup>47</sup> The SEC has said that a shareholder always reserves the right to revoke consent to electronic delivery and insist on paper copies of corporate documents.<sup>48</sup>

Finally, the SEC wants the method of delivery of the data to be at least as reliable as the U.S. mail, thereby providing reasonable assurance that the delivery requirement is satisfied.<sup>49</sup> The delivery requirement may be satisfied by:

- (1) obtaining an informed consent from an investor to receive the information electronically;
- (2) obtaining evidence that an investor actually received the information, for example, by electronic mail return-receipt;
- (3) disseminating information via facsimile;
- (4) hyperlinking required documents; and
- (5) using forms or other material available only by accessing the information.<sup>50</sup>

Delivery and notice can be assumed, however, when materials are provided by an employer through an E-mail to employees who regularly receive electronic communications during work.<sup>51</sup>

As a result of these changes, the vast majority of public corporations with Web sites are publishing their annual reports on-line. Investors may have an easier time finding the annual reports of different companies through

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<sup>44</sup>S.E.C. Release No. 33-7288, May 9, 1996, *available in* 1996 SEC LEXIS 1299, at \*18.

<sup>45</sup>*See id.*

<sup>46</sup>*See id.*

<sup>47</sup>*See id.* at \*15.

<sup>48</sup>S.E.C. Release No. 33-7288, May 9, 1996, *available in* 1996 SEC LEXIS 1299, at \*15.

<sup>49</sup>S.E.C. Release No. 33-7233, Oct. 6, 1995, *available in* 1995 SEC LEXIS 2662, at \*19.

<sup>50</sup>*Id.*

<sup>51</sup>S.E.C. Release No. 33-7288, May 9, 1996, *available in* 1996 SEC LEXIS 1299, at \*37 (clarifying the issuer's ability to use a company's internal E-mail system or Web site to disseminate required investor information to employee-shareholders without first obtaining their consent). The SEC indicated that no advance consent was needed if (1) the company provided the E-mail and/or Internet access; (2) the employees were expected to check their E-mail regularly; (3) E-mail messages either provided the document or advised the employees where it could be viewed; and (4) the employees could request a paper copy. *See id.* at \*37-\*38.

the Public Register's Online Annual Report Services.<sup>52</sup> This service provides investors access to over 1,600 annual reports through an alphabetical list of companies and hypertext links that quickly take the investor to the desired report.<sup>53</sup>

b. *Electronic Proxies*

Corporations are increasingly encouraging their investors to vote either telephonically or electronically. For example, ADP Shareholder Services, which handles distribution of proxy materials for virtually every major bank and brokerage firm, offered telephonic and Internet voting to stockholders of approximately 1,000 companies during the 1998 proxy season.<sup>54</sup> According to a survey that the American Society of Corporate Secretaries is currently compiling, approximately 200 companies offered telephonic voting, and 50 offered Internet voting during that same proxy season.<sup>55</sup> Not surprisingly, most of the participating companies were technology or telecommunications companies.<sup>56</sup>

States have been amending their corporate statutes to keep pace with emerging technologies. In Delaware, for example, Section 212 of the Delaware General Corporation Law (DGCL) was amended in 1990 to validate certain types of electronic proxies, including those sent via facsimile and those registered via "proxygrams" or "datagrams."<sup>57</sup> Now a stockholder can grant a proxy over the Internet, provided it can be determined that the transmission, pursuant to which the proxy was granted, was authorized by the stockholder.<sup>58</sup> Such verification information may include: a Social Security number, birth date, personal identification number, or control number. If a company sought greater security than it could achieve through the use of unique control numbers, it could encrypt its transmissions.<sup>59</sup>

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<sup>52</sup>Annual Report Service - The Public Register's Annual Report Service <<http://www.annualreportservice.com>>.

<sup>53</sup>*See id.*

<sup>54</sup>*See* Ronald O. Mueller, *Electronic Communication in the Proxy Solicitation Process: The 1998 Proxy Season in Review*, WALLSTREET LAW., 2 No. 5 GLWSLAW 1, at 1.

<sup>55</sup>*See id.*

<sup>56</sup>*See id.*

<sup>57</sup>These terms refer to a procedure in which a record shareholder, by using a toll-free telephone number, communicates his or her vote in telegraphic or datagram form. This practice has become widespread among professional proxy solicitors.

<sup>58</sup>*See* Michael D. Goldman et al., *Online Issues In Corporate Law: The Impact of New Technology on Investor Relations*, 11TH ANNUAL TULANE CORPORATE LAW INSTITUTE, Mar. 1999.

<sup>59</sup>ABA, DIGITAL SIGNATURE GUIDELINES: LEGAL INFRASTRUCTURE FOR CERTIFICATION AUTHORITIES AND SECURE ELECTRONIC COMMERCE (1996). One method of encryption is the "digital signature," an encoded message that assures the recipient of the identity of the sender. *See id.* Creation of the digital signature involves encryption of the message using a "private key" known only to the signer, and a "public key," available to anyone who may read the sender's message. *See id.* Anyone who has the public key can send messages that only the

c. *Electronic Consents*

Stockholders and boards of directors are permitted to take actions without a meeting, if they obtain the requisite written consents. The use of written consents has become increasingly popular, both as a means to simplify corporate governance and as a powerful tool in contests for corporate control. Under Delaware law, unless limited by the certificate of incorporation, any action that could be taken by stockholders at a meeting may be taken without a meeting, without prior notice, and without a vote, if the requisite number of stockholders consent to the action "in writing."<sup>60</sup> Although the Delaware legislature has not expressly amended section 228 to allow for electronic consents (as it did with its 1990 amendment of section 212 to allow electronic proxies), there can be little doubt of their acceptance in the future.

d. *Notice Requirements*

The concept of notice is also evolving in this electronic age. In Delaware, for example, Section 222 of the DGCL provides that "written notice" of a stockholder's meeting must be given to the stockholders.<sup>61</sup> While it is unresolved under Delaware law whether notice via the Internet and/or E-mail would satisfy the written notice requirement for purposes of Section 222(b), it is reasonable to conclude that electronic notice would be sufficient, as long as it is permitted by the company's bylaws and certificate.<sup>62</sup> In another context, the United States District Court for the District of South Carolina held that a computer disk mailed or delivered to an insurance agent could constitute "written notice" to an agent, required in order to cancel a policy for the nonpayment of premiums.<sup>63</sup> In all events, electronic notice will undoubtedly be the wave of the future.

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private-key owner can read, and the private key can be used to send messages that could only have been sent by that private-key owner. *See id.* Since the publication, 30 states and the District of Columbia have enacted legislation on the use of digital or electronic signatures.

<sup>60</sup>DEL. CODE ANN. tit. 8, § 228(a) (1998).

<sup>61</sup>*See id.* § 222(a)-(b).

<sup>62</sup>Goldman et al., *supra* note 57.

<sup>63</sup>*See* Clyburn v. Allstate Ins. Co., 826 F. Supp. 955, 957 (D.S.C. 1993). "In today's 'paperless' society of computer generated information, the court is not prepared, in the absence of some legislative provision or otherwise, to find that a computer floppy diskette would not constitute a 'writing' within the meaning of § 38-75-730." *Id.* (footnote omitted).

e. *Electronic Attendance at Annual Stockholder Meetings*

An increasing number of companies allow stockholders to view annual meetings via the Internet and to ask questions during the meeting. The first company to do so was Bell & Howell, a Delaware corporation. After going public (for the second time) in 1995, the company was seeking a way to improve its image as a high-tech company. It also wanted to get its message out to stockholders around the world. Therefore, in May 1996, the company allowed stockholders to view its first meeting on-line. While only forty stockholders physically attended the meeting, more than 950 viewed it on-line. Investors could hear what was going on, through the Web site's audio function, and could simultaneously view the charts and graphs presented on PowerPoint slides. Those persons monitoring via the Internet were not, however, considered "present" for quorum or voting purposes.

In 1997, Bell & Howell added on-line proxy voting, and more than four million shares were voted through electronic proxies. More than seventeen hundred stockholders viewed the meeting simultaneously on-line that year, many of them from overseas, and an additional 1,603 visited the archived file after the meeting. In addition, the on-line attendees were permitted to E-mail questions to directors as early as two days before the meeting and while the meeting was in progress. All of the questions were read and answered during the meeting. According to Bell & Howell one of the benefits of allowing real-time on-line access to meetings has been the low cost, between \$10,000 and \$12,000, to provide on-line access. The company saw its return on the investment as the creation of a positive image from using technology to deliver information to its stockholders.

Viewing the meeting on-line is not the same as "attending" a meeting for quorum and voting purposes. Internet viewing does not satisfy the latter.<sup>64</sup> Once again, as technology improves and advances, corporate law will undoubtedly evolve to allow stockholders "attending" a meeting via the Internet to be counted for quorum purposes and to be entitled to vote.

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<sup>64</sup>See, e.g., DEL. CODE ANN. tit. 8, § 222(a) (1998) (requiring written notice of the time and place of the annual meeting); see *id.* § 216 (stating that both quorum and the attainment of the vote of sufficient shares depend upon stockholders being present "in person" or represented by proxy); see also *Berlin v. Emerald Partners*, 552 A.2d 482, 491-94 (Del. 1988) (discussing the distinction between quorum and voting power and stating that "[i]f a stockholder is not present in person, and if he is not given a proxy to vote on the proposed Business Combination, his stock cannot be regarded as 'voting power present,' for purposes of the vote required under the supermajority provision").

f. *Electronic Attendance at Board Meetings*

Board meetings may already be conducted electronically.<sup>65</sup> The overriding requirements are hearing and participation. Accordingly, as long as all board members have audio equipment attached to their computers, true dialogue can occur. Additional potential benefits include allowing participants simultaneously to view and edit documents, spreadsheets, and PowerPoint slides. Thus, the directors could potentially have access to all of the information and material upon which the decision is based, in order to properly carry out their duty of due care. Undoubtedly, advances in electronics, communications, and video-conferencing capabilities will add even greater flexibility to the conduct of board meetings in the future.

B. *Globalization*

1. *Disintegrating Boundaries*

The world is shrinking. Advances in transportation, technology, and communications are bringing the world closer together, and are having amazing effects on the economy. Jim Reed, director of European programs for Dell Computer Corporation of Round Rock, summarized the effect of globalization as follows: "[t]he country boundaries, the currency boundaries, will be replaced by boundaries of groups of people who are distinguished only by their buying preferences."<sup>66</sup>

Not only will boundaries disappear, but fundamental changes are likely to occur in the way corporations do business. For example, experts predict substantial changes in the structure of the workforce in the next century. Increasing globalization will lead to round-the-clock work schedules and the elimination of the typical Monday-through-Friday work week, as companies strive to serve clients in time zones around the world.<sup>67</sup> "[M]any workers will essentially be self-employed, forming an army of on-call specialists and permanent part-time employees."<sup>68</sup> New management techniques will be developed to help supervisors deal effectively with this

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<sup>65</sup>See, e.g., DEL. CODE ANN. tit. 8, § 141(i) (1991) (permitting members of the board to participate "by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other").

<sup>66</sup>Bert Roughton, Jr., *The Euro Arrives, Europeans Grudgingly Give Up a Bit of National Identity in Historic Step Toward Unity*, AUSTIN AMERICAN-STATESMAN, Jan. 3, 1999, at G1.

<sup>67</sup>See Greg Weatherford, *Flexibility Will Be the Hallmark for Offices in the Years Ahead*, KNIGHT-RIDDER TRIB. BUS. NEWS, Dec. 28, 1998.

<sup>68</sup>*Id.*

self-managing work force.<sup>69</sup> Increasingly, specialized workers will become more valuable, prompting employers to go to great lengths to keep them on staff and to help them better balance work and home life without sacrificing career advancement.<sup>70</sup>

## 2. European Monetary Union

Perhaps the greatest example of change that is afoot is the European Monetary Union (EMU). The EMU was structured as a three stage process, designed to unify the economies of fifteen European nations.<sup>71</sup> The EMU features the introduction of a single European currency, the euro. The introduction of which has been called, "a critical step in the grand plan of the European Union, the bold melding of once querulous nations into a peaceful, economic-and-monetary bloc."<sup>72</sup> Interest rates will be set by a Central European Bank, which will also deal with issues including inflation management and other economic policy making. Individual euro countries, however, will still maintain control over taxation, wages, and labor law.

Stage 1, that ran from July 1, 1990, to December 31, 1993, involved the removal of restrictions on capital movements, or transfers of money, and the movement towards closer coordination of macroeconomic policy coordination.<sup>73</sup> Stage 2, that ran from January 1, 1994, to December 31, 1998, included the creation of the European Monetary Institute (EMI) and preparation for a single currency.<sup>74</sup>

Stage 3 began on January 1, 1999 with the introduction of the euro, trading at approximately \$1.17.<sup>75</sup> Currently, the euro mostly exists as "virtual money," primarily found on credit card and bank statements.<sup>76</sup> Still, overnight, the euro zone became the second largest economy in the world.<sup>77</sup>

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<sup>69</sup>*See id.*

<sup>70</sup>*See Weatherford, supra note 66.*

<sup>71</sup>Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom (collectively, the Member States); Brian Grulke, *Introducing the Euro*, MARKETPLACE MAG., Feb. 2, 1999 (indicating that Denmark, Sweden, and the United Kingdom have opted out of certain aspects, including the introduction of the euro, and that Greece did not meet the European Community economic requirements to use the euro).

<sup>72</sup>Anne Thompson, *Border-Crossing Neighbors Eager for Euro Introduction*, AUSTIN AMERICAN-STATESMAN, Feb. 16, 1999, at D5.

<sup>73</sup>*See William F. Doescher, The Euro Rings in the New Year*, CREDIT WORLD, Jan./Feb. 1999.

<sup>74</sup>*See id.*

<sup>75</sup>*See id.*; Roughton, *supra* note 65, at G1.

<sup>76</sup>*See Roughton, supra note 65, at G1.*

<sup>77</sup>*See Doescher, supra note 72.*

National notes and coins will be completely withdrawn by July 1, 2002, and the euro will become the official currency in the participating EMU states.<sup>78</sup> Eventually, it is anticipated that the euro will gain the esteem of the yen and the American dollar.<sup>79</sup> Indeed, there are reports that the London market is currently unhappy at not being included in the euro market, and there are pressures for the U.K. to join in this aspect of Europe's monetary union.<sup>80</sup> Stage 3 also features the commencement of a single European monetary system, with the European System of Central Banks (ESCB) imposing one interest rate.<sup>81</sup>

Because of increasing interdependence of global economics, the introduction of the euro has already had, and will continue to have, ripple effects throughout the world.<sup>82</sup> One commentator explained the likely advantages to the U.S. as follows:

Corporations in the United States, especially larger ones, will benefit from dealing with just one currency. The euro will create a greater demand for banks, corporations, and central banks to keep individual portfolios up to date. The euro will lower the price of currency and the price of doing foreign business. It also will be less costly to hedge the currency risk with the euro. The monetary competition also is good for the country.<sup>83</sup>

Other economic advantages are expected. Business costs will be significantly reduced, as Europeans and travelers in the euro zone will no longer have to change currencies when they move from one country to another.<sup>84</sup> Transparency in prices is expected to follow, as are cheaper prices to consumers resulting from the lower cost of doing business.<sup>85</sup> "EU governments will come under increasing pressure to trim the regulatory burden."<sup>86</sup> It is also anticipated that the euro will lead to more mergers and consolidations, especially in markets such as banking and manufacturing. This will have an overall economical benefit.<sup>87</sup>

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<sup>78</sup>*Id.*

<sup>79</sup>*See* Grulke, *supra* note 70.

<sup>80</sup>*See id.*

<sup>81</sup>*See* Doescher, *supra* note 72.

<sup>82</sup>*See id.*

<sup>83</sup>Grulke, *supra* note 70.

<sup>84</sup>*See* Doescher, *supra* note 72.

<sup>85</sup>*See id.*

<sup>86</sup>John Dlodlu, *What the Euro Means for Africa*, AFRICA TODAY, Feb. 6, 1999.

<sup>87</sup>*See* Grulke, *supra* note 70.

### 3. European Stock Corporation

Another important, yet controversial, part of the movement towards European unity is the push for a European Company Statute. The first proposal for the European Company Statute was submitted in 1970, then amended in 1975, and again in 1989.<sup>88</sup> "The Proposal takes the form of a Regulation based upon Article 235 of the [European Community Treaty of 1992 (EC Treaty)]."<sup>89</sup> The proposed European Company Statute

would make it possible for two or more companies from different Member States to form a new company by means of a merger. The newly formed company would be a genuinely supranational corporation subject primarily to [the EC], as opposed to Member State, law. Member State law would come into play only if no European law on point exists. In such a case, the law of the Member State in which the European Company has its principal place of business would apply.<sup>90</sup>

While not yet adopted, and controversial in many respects, the concept of a European Company statute portends a movement towards a supranational corporate form.

#### C. Corporate Monitoring

A study published in the early 1930s, by Berle and Means,<sup>91</sup> observed the following paradigm in then modern corporations: the separation of ownership and control.<sup>92</sup> A collective action problem resulted because stockholders of publicly held firms were often too widely dispersed to effectively monitor the firm's managers. That separation of ownership and control continues, and in many respects has increased, today. There are, however, several current trends suggesting a reversal.

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<sup>88</sup>See Werner F. Ebke, *Company Law and the European Union: Centralized Versus Decentralized Lawmaking*, 31 INT'L LAW. 961, 975 (Winter 1997).

<sup>89</sup>*Id.*

<sup>90</sup>*Id.*

<sup>91</sup>See ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 119-25 (1933).

<sup>92</sup>See David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1326 (1998).



## 1. Leveraged Buy-Outs

A leveraged buy-out (LBO) represents an example of "eschewing the Berle-Means corporation in favor of concentrated shareholding by entrepreneurial managers."<sup>93</sup> LBO partnerships takeover firms and then either install new managers, or give the already existing managers compensation that ensures good performance.<sup>94</sup> "By reducing the separation between ownership and control, LBO firms diminish managerial agency costs and seem to offer a dramatically more efficient alternative to the traditional publicly held firm."<sup>95</sup>

## 2. Outside Directors

Independence of directors has been described as "[p]erhaps the most effective stockholder protection device" available.<sup>96</sup> Former Delaware Chancellor William T. Allen explained the virtues of independence in an October 1997 speech to the National Association of Corporate Directors Annual Meeting:

Director independence does not assure that a director will make a better contribution on the board than an insider might make. Independent directors may have less information about the firm and may, in fact, tend to make less brilliant decisions over time than those with a close financial interest in the firm. Nevertheless, independence offers to investors some further assurance that the governance process has integrity.<sup>97</sup>

Perhaps as a result, outside directors are gaining prominence. As the following numbers demonstrate, while once the reverse, outsiders now substantially outnumber insiders.<sup>98</sup>

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<sup>93</sup>*Id.* at 1390.

<sup>94</sup>*See id.* (referring to Kohlberg Kravis & Roberts).

<sup>95</sup>*Id.*

<sup>96</sup>E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 *BUS. LAW.* 681, 687 (May 1998).

<sup>97</sup>*Id.* at 688.

<sup>98</sup>*See* Richard M. Ferry, *Boardrooms Yesterday, Today and Tomorrow*, *CHIEF EXECUTIVE*, Mar. 1999, at 44. Ferry details survey results from the Korn/Ferry International Study assessing views from over 14,000 CEOs, chairmen and directors since 1973. 1999's study included views from 1,020 participants.

YEAR	TOTAL BOARD MEMBERS	INSIDE DIRECTORS	OUTSIDE DIRECTORS
1973	10-15 (57% of all U.S. boards)	4-6 true insiders, <b>plus</b> 2-3 consultants, bankers, attorneys	4-6 true outsiders
1988	14	4	10
1998	11	2	9

Outside directors are increasing not only in numbers, but also in influence. CEOs and directors note a distinct emergence of independent audit, compensation, and nominating committees.<sup>99</sup> In 1973, only two percent of all boards had a nominating committee. Ten years ago, only the audit committee was made up entirely of outside directors.<sup>100</sup> "Today, 74 percent of all boards have a nominating committee entirely composed of independent outside directors."<sup>101</sup> Trends aimed at enhancing accountability, identified in a recent study, include the following: establishing CEO performance reviews; establishing board performance reviews; requiring retired CEOs to leave the boards; requiring CEOs and directors to own a certain amount of stock; holding meetings of the independent directors without the CEO present; appointing committee chairs and members by the board, not the CEO; and increasing the percentage of independent directors on boards.<sup>102</sup>

### 3. Institutional Investor Activism

"The bull market of the 1990s has coincided with a surge in shareholder activism that appears to have spurred remarkable performance in many stocks and contributed to the overall market's gains as well."<sup>103</sup> "Managements that fail to heed their [share]holders' wishes increasingly find themselves subject to glaring scrutiny."<sup>104</sup> Last year, for example,

stock in Marriott International rallied after its union and several major holders, including the California Public

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<sup>99</sup>*See id.*

<sup>100</sup>*See id.*

<sup>101</sup>*Id.*

<sup>102</sup>*See* Ferry, *supra* note 97, at 44.

<sup>103</sup>Greg Ip, *As Activists Flex Muscles, Bull Charges Ahead*, WALL ST. J., June 8, 1998, at C1.

<sup>104</sup>*Id.*

Employees' Retirement System [(CalPERS)], defeated management's proposal to create two classes of stock. Utility company Entergy's stock . . . rose 7.6% as the company brought in a new chief executive officer after shareholders made their dissatisfaction with the share price known.<sup>105</sup>

The country's largest two pension management entities have both taken a lead in shareholder activism, albeit in different ways.<sup>106</sup> CalPERS, for example, publishes a "10 Worst Boards" list, and actively campaigns these poor performers to improve their corporate governance practices.<sup>107</sup> In recent years, CalPERS has pushed directors to replace the leaders of General Motors, Eastman Kodak Company, and International Business Machines.<sup>108</sup> Unlike CalPERS' highly public "in-your-face approach" to dictating appropriate governance principles, Teachers takes a kinder, gentler stance.<sup>109</sup> Teachers' behind-the-scenes efforts, however, have not precluded public skirmishes altogether.

Three occasions over the past year saw [Teachers] flexing its institutional muscles to protect the value of its investments — filing a shareholder resolution urging Walt Disney Co. to restructure its board, rounding up proxies and turning out the entire board of directors at cafeteria company Furr's/Bishop's [following their approval of several self-enrichment programs] and negotiating reforms at ERAMET, a recently privatized French company[, following the French government's attempt to give away a company mine to appease a local group].<sup>110</sup>

Activism is now also being carried out by specialized investors who buy stakes in undervalued companies, aiming to shake up management. "Last October, [for example,] Storage Technology, a manufacturer of computer storage devices, announced an \$800 million stock buyback several days after Relational Investors LLC, a La Jolla, Calif[ornia], shareholder-

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<sup>105</sup>See *id.* (describing Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF or Teachers) with \$223 billion in assets under management, and CalPERS with \$127 billion in assets).

<sup>106</sup>Jennifer Pellet, *Teachers Expands Its Curriculum*, CHIEF EXECUTIVE, Nov. 1, 1998, at 44.

<sup>107</sup>See Joann S. Lublin & Sara Calian, *Activists Pension Funds Create Alliance Across Atlantic to Press Lackluster Firms*, WALL ST. J., Nov. 23, 1998, at A4.

<sup>108</sup>See *id.*

<sup>109</sup>See Pellet, *supra* note 105, at 44.

<sup>110</sup>*Id.* at 44.

activist fund, went public with its ownership stake and demands for a hefty buyback. Since then, the stock has rallied 57%.<sup>111</sup>

The Council of Institutional Investors<sup>112</sup> believes two major factors have propelled the increased activism.<sup>113</sup> First, "[t]here's been an explosive growth in the amount of stock held by institutional investors."<sup>114</sup> Indeed, "[s]ince 1990, the share of domestic stock held by institutions has risen to 65% from 51%, according to Georgeson & Co., a New York firm specializing in shareholder analysis."<sup>115</sup> Second, the SEC facilitated its proxy-communication rules by approving a package of corporate proxy rule reforms that made it substantially easier for institutions to communicate with one another, to discuss concerns regarding companies where they had holdings, and to team up and coordinate voting efforts.<sup>116</sup> The Internet has been credited as a third factor fueling shareholder activism, because it gives investors better access to company information.<sup>117</sup>

According to Maryanne Moore, director of the corporate governance service of the Investor Responsibility Research Center (IRRC), the IRRC expected "1999 institutional shareholder efforts to be focused primarily in the areas of executive pay, the repricing of 'underwater' options and poison pills."<sup>118</sup> Another area where she said the group expected increased activity was "the examination of many companies' audit committees, in light of the recent formation of a task force between the SEC and the National Association of Corporate Directors to ensure auditors are qualified for their positions and not simply assigned."<sup>119</sup>

Institutional activism is now going global. In late 1998, CalPERS formed an unusual trans-Atlantic alliance with Hermes Pensions Management Ltd., Britain's biggest pension-fund manager, to push for changes in companies where they both hold stakes.<sup>120</sup> Greater cross-border coordination among activist investors seems inevitable. "We would like to have alliances in other countries because the world is becoming a global marketplace," said William D. Crist, president of CalPERS' board of

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<sup>111</sup>Ip, *supra* note 102, at C1.

<sup>112</sup>See *id.* (describing the council as representing more than 100 pension funds, with assets exceeding \$1 trillion).

<sup>113</sup>See *id.*

<sup>114</sup>*Id.*

<sup>115</sup>Ip, *supra* note 102, at C1.

<sup>116</sup>See *id.*

<sup>117</sup>See Morgan Mellish, *Funds Flex Muscles*, SYDNEY MORNING HERALD, Sept. 17, 1998, at 35.

<sup>118</sup>*Institutional Shareholders Expected to Flex Their Muscles as Proxy Season Begins*, SECURITIES WK., Dec. 14, 1998, at 11.

<sup>119</sup>*Id.*

<sup>120</sup>See Lublin & Calian, *supra* note 106, at A4.

administration.<sup>121</sup> With global markets, concurred principal of Lens, Inc., a Washington activist fund, Nell Minow, "you should have global corporate governance, too."<sup>122</sup> Chairman and CEO of Teachers, John Biggs, agrees. Commenting on Teachers' efforts to take activism overseas, Biggs observed, "There's been steady progress. I think the success of American corporate governance has not been ignored by the Europeans, nor the Japanese. They're beginning to think that there may be something to Anglo-American governance. We're really making headway toward international standards."<sup>123</sup>

#### 4. Technology

Some commentators have argued that advances in technology are also likely to increase corporate accountability.<sup>124</sup> Technology, they argue, has increased the transparency of managerial actions by making it possible for different stockholders to follow almost every move a company makes.<sup>125</sup> Companies have responded by offering detailed explanations of their moves, in real time, on the Internet.<sup>126</sup>

#### 5. Development of Monitoring Intermediaries

At least one commentator is encouraging shareholders to use corporate monitoring firms (CMFs) in an effort to control the director nomination process, and thereby take a much more active role in company business.<sup>127</sup> Under this system, a stockholder could vote for a CMF, that would, in turn, nominate directors. Latham suggests that this evolution is a natural progression from other forms of shareholder monitoring including: takeovers, breach of fiduciary lawsuits, institutional investor activism, incentive compensation, and director independence. The purported benefits would include: enhancing shareholder return (monitoring would lead to more judicious deployment of capital), encouraging the dissemination of information to shareholders, limiting CEO power, fighting short-termism, and promoting social welfare.<sup>128</sup>

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<sup>121</sup>*See id.*

<sup>122</sup>*Id.*

<sup>123</sup>Pellet, *supra* note 105, at 44.

<sup>124</sup>*See Zahra, supra* note 28.

<sup>125</sup>*Id.*

<sup>126</sup>*See id.*

<sup>127</sup>*See* Mark Latham, *Corporate Monitoring: New Shareholder Power Tool*, FINANCIAL ANALYSTS J., Sept./Oct. 1998, at 9.

<sup>128</sup>*See id.* at 10-12.

## D. *Private Ordering*

### 1. Overview

Delaware has long been the leader in corporate law. Nearly 300,000 corporations have incorporated in Delaware, including more than fifty percent of the Fortune 500 and New York Stock Exchange companies.<sup>129</sup> Reasons often cited for Delaware's prominence include:

- Delaware's well established and predictable principles of corporate governance;
- the ability and willingness of the Delaware legislature and courts to act quickly and efficiently to meet changing business needs;
- the expertise of Delaware Court of Chancery Chancellors in handling corporate issues; and
- the existence of a substantial body of case law interpreting Delaware statutes.<sup>130</sup>

Another benefit afforded under Delaware law is private ordering. "The Delaware General Corporation Law is an enabling act that provides wide discretion to fine-tune intra-corporate arrangements."<sup>131</sup> In a closely held corporation, there are numerous opportunities to negotiate agreements between the stockholders and the corporation. Fewer opportunities for private ordering are found in large publicly held companies.

Delaware courts have repeatedly demonstrated that they respect the parties' right to private ordering and will hold the parties to their bargain. Several cases have done so in the limited partnership context. In *In re Cencom Cable Income Partners, L.P. Litig.*,<sup>132</sup> for example, limited partners unsuccessfully sought to enjoin the general partner's attempt to purchase the partnership assets, distribute the net proceeds, and liquidate the partnership, all pursuant to the terms of the partnership agreement.<sup>133</sup> The limited partners argued that the general partner was breaching his fiduciary duties

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<sup>129</sup>See, e.g., Veasey, *supra* note 95, at 682.

<sup>130</sup>See, e.g., *id.* at 683 (citing Hewlett Packard Co., 1998 Proxy Statement 22-24 (1998), which sought to reincorporate the company in Delaware from California; the reincorporation was approved by a substantial majority of shareholders).

<sup>131</sup>Veasey, *supra* note 95, at 686; see also *Williams v. Geier*, 671 A.2d 1368, 1381 (Del. 1996) ("At its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial private ordering . . .").

<sup>132</sup>No. 14,634, 1996 Del. Ch. LEXIS 17 (Del. Ch. Feb. 15, 1996).

<sup>133</sup>See *id.* at \*1-\*2.

and had the burden of proving that the terms of the asset sale agreement were entirely fair to the limited partners.<sup>134</sup> The court held, however, that the general partner's relationship to the limited partners was primarily "contractual in nature," like that of a corporation to its preferred stockholders.<sup>135</sup> The court noted that great deference was due to the parties' choices:

A court should assume that parties involved in commerce who elect to join together in a business organization to pursue an enterprise have substantial knowledge of a wide range of business operational frameworks. One can further assume these parties make a thoughtful election with full knowledge of the significance of the operational framework they choose.<sup>136</sup>

Because the Delaware Revised Limited Partnership Act (DRLPA) permits partners to modify fiduciary duties by contract,<sup>137</sup> the court reasoned that the limited partnership agreement could "authorize actions creating a 'safe harbor' for the general partner under circumstances which might otherwise be questionable."<sup>138</sup> In that situation, the question of "whether a general partner acts in good faith, with due care or with requisite loyalty may be determined by the consistency to which the general partner adheres to its contractual obligations,"<sup>139</sup> not some judicially mandated normative standard. Thus, the court concluded, "While the General Partner stands on both sides of the transaction, it presumably bargained for and clearly obtained the Limited Partners' consent to do so in the Partnership Agreement."<sup>140</sup>

In *Sonet v. Timber Company, L.P.*,<sup>141</sup> the court explained the increasing prevalence of limited partnerships as follows: "One might

<sup>134</sup>*See id.* at \*3.

<sup>135</sup>*Id.* at \*4 (citing *H.B. Korenvaes Invs., L.P. v. Marriott Corp.*, No. 12,922, mem. op. at 9 (Del. Ch. June 9, 1993), reprinted in 19 DEL. J. CORP. L. 736 (1994)).

<sup>136</sup>*Cencom*, 1996 Del. Ch. LEXIS 17, at \*4.

<sup>137</sup>Section 17-1101(d) of the Delaware Revised Uniform Limited Partnership Act provides, in pertinent part:

[t]o the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited partnership or to another partner . . . , and . . . the partner's or other person's duties and liabilities may be expanded or restricted by the provisions in a partnership agreement.

DEL. CODE ANN. tit. 6, § 17-1101(d) (1999).

<sup>138</sup>*Cencom*, 1996 Del. Ch. LEXIS 17, at \*4.

<sup>139</sup>*Id.*

<sup>140</sup>*Id.* at \*5.

<sup>141</sup>722 A.2d 319 (Del. Ch. 1998).

reasonably conclude that the statutory authority granted to limited partnerships to contract around — or to enhance — fiduciary duties goes a long way in explaining this popularity.<sup>142</sup> In *Sonet*, the limited partners brought suit against the limited partnership's general partner and that general partner's general partner, alleging breach of fiduciary duty in connection with a merger to convert the limited partnership into a real estate investment trust.<sup>143</sup> In granting defendants' motion to dismiss, the court found that "a claim of breach of fiduciary duty must first be analyzed in terms of the operative governing instrument — the partnership agreement — and only where that document is silent or ambiguous, or where principles of equity are implicated, will a Court begin to look for guidance from the statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence."<sup>144</sup> In other words, "[P]rinciples of contract preempt fiduciary principles where the parties to a limited partnership have made their intentions to do so plain."<sup>145</sup> Here, the partnership agreement gave the general partner the sole discretion to propose a merger on consolidation, subject only to a two-thirds vote of unitholders.<sup>146</sup> According to the court, "This careful framework established by the Agreement confirms that to the extent that unitholders are unhappy with the proposed terms of the merger (and in this case the resultant conversion) their remedy is the ballot box, not the courthouse."<sup>147</sup>

The Delaware Supreme Court recently extended these freedom of contract principles to the limited liability company (LLC) context in *Elf Atochem North America, Inc. v. Jaffari*.<sup>148</sup> Noting that the LLC Act is designed to "permit persons or entities ('members') to join together in an environment of private ordering,"<sup>149</sup> the court held that the members were free to predetermine the forum in which disputes would be resolved and upheld the LLC agreement's arbitration clause.<sup>150</sup> According to the court:

we find no reason why the members cannot alter the default jurisdictional provisions of the statute and contract away their right to file suit in Delaware. . . . We hold that, because the policy of the Act is to give the maximum effect to the principle

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<sup>142</sup>*Id.* at 323.

<sup>143</sup>*See id.* at 320-21.

<sup>144</sup>*Id.* at 324.

<sup>145</sup>*Sonet*, 722 A.2d at 322.

<sup>146</sup>*See id.* at 325.

<sup>147</sup>*Id.* at 326.

<sup>148</sup>727 A.2d 286 (Del. 1999).

<sup>149</sup>*Id.* at 287.

<sup>150</sup>*See id.*



of freedom of contract and to the enforceability of LLC agreements, the parties may contract to avoid the applicability of Sections 18-110(a), 18-111, and 18-1001. Here, the parties contracted as clearly as practicable when they relegated to California in Section 13.7 "any" dispute "arising out of, under or in connection with [the] Agreement or the transactions contemplated by [the] Agreement . . . ." <sup>151</sup>

As these cases demonstrate, private ordering is respected in Delaware.

## 2. Proliferation of LLCs

Perhaps the most prominent example of the trend toward private ordering is the increasing popularity of the LLC. As recently described by the Delaware Supreme Court, "The phenomenon of business arrangements using 'alternative entities' has been developing rapidly over the past several years. Long gone are the days when business planners were confined to corporate or partnership structures."<sup>152</sup> As described below, the authors submit that this current trend is a precursor to substantially more private ordering in the future.

The LLC is a relatively new entity that has emerged in recent years as an attractive vehicle to facilitate business relationships and transactions.

[I]t is designed to achieve what is seemingly a simple concept — to permit persons or entities ('members') to join together in an environment of private ordering to form and operate the enterprise under an LLC agreement with tax benefits akin to a partnership and limited liability akin to the corporate form.<sup>153</sup>

In 1977, Wyoming was the first state to adopt an LLC provision as part of its statutory scheme. Now all fifty states and the District of Columbia have enacted LLC acts.

The driving forces behind the LLC revolution are the LLC's combined advantages of corporate-like limited liability, with partnership flow-through tax treatment.<sup>154</sup> "Indeed, the LLC has been characterized as the 'best of both

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<sup>151</sup>*Id.* at 295 (citing DEL. CODE ANN. tit. 6, § 18-1101(b) (1999)).

<sup>152</sup>*Elf Atochem N. Am.*, 727 A.2d at 289-90.

<sup>153</sup>*Id.* at 286.

<sup>154</sup>*See* LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 2.02, at 2 (1998) (explaining business law considerations in choosing the LLC form); Martin I. Lubaroff & Paul M. Altman, *Delaware Limited Liability Companies*, in DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 20.1 (R. Franklin Balotti & Jesse A. Finkelstein eds., 1998) (explaining federal income tax ramifications of choosing the LLC form).

worlds."<sup>155</sup> The flow-through tax treatment allows members to avoid the double taxation problem of the traditional corporate form whereby income is taxed twice: once at the corporate level as income, and then again at the shareholder level as dividends.<sup>156</sup> LLCs also have significant non-tax advantages, including: flexible management choices, liberal member qualification requirements, and flexible capital structures.<sup>157</sup> LLC-type entities are also credited with addressing problems that inhibit innovation within the corporate form by "break[ing] down barriers to corporate contracting by offering different sets of choices."<sup>158</sup>

Another significant benefit of the LLC concept is its promotion of maximum flexibility by allowing members to structure their relationship, virtually any way they want, from the very beginning. "The [Delaware LLC] Act can be characterized as a 'flexible statute' because it generally permits members to engage in private ordering with substantial freedom of contract to govern their relationship, provided they do not contravene any mandatory provisions of the Act."<sup>159</sup> Section 18-1101 of the Act provides as follows:

CONSTRUCTION AND APPLICATION OF CHAPTER  
AND LIMITED LIABILITY COMPANY AGREEMENT.

- (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.
- (b) ***It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.***

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<sup>155</sup>*Elf Atochem N. Am.*, 727 A.2d at 290 (quoting Lubaroff & Altman, *supra* note 153, § 20.1).

<sup>156</sup>In December 1996, the IRS adopted Regulation 301.7701 effective January 1, 1997, to simplify the classification of an entity for tax purposes. Any business entity not required to be treated as a corporation for federal tax purposes, may choose its classification, leading to the popular "Check the Box" name for this Regulation. I.R.C. § 301.7701 (1999).

<sup>157</sup>See William H. Copperthwaite, Jr., *Limited Liability Companies: The Choice for the Future*, 103 COMMERCIAL L.J. 222, 222 (1998).

<sup>158</sup>*Id.* at 223.

<sup>159</sup>*Elf Atochem N. Am.*, 727 A.2d at 290 (citing JAMES D. COX ET AL., CORPORATIONS § 1.12, at 1.37-.38 (1999)).

- (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager:
  - (1) Any such member or manager or other person acting under a limited liability company agreement shall not be liable to the limited liability company or to any such other member or manager for the member's or manager's or other person's good faith reliance on the provisions of the limited liability company agreement; and
  - (2) The member's or manager's or other person's duties and liabilities may be expanded or restricted by provisions in a limited liability company agreement.<sup>160</sup>

To date, the Delaware Act has been amended six times with a view towards modernization. As shown, Section 18-1101(b) of the Act, like the essentially identical Section 17-1101(c) of the DRLPA, provides that "[i]t is the policy of [the Act] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."<sup>161</sup> The Act provides its members with the discretion to contractually define their business understanding."<sup>162</sup> Accordingly, the following observation relating to limited partnerships applies, as well, to limited liability companies:

The Act's basic approach is to permit partners to have the broadest possible discretion in drafting their partnership agreements and to furnish answers only in situations where the partners have not expressly made provisions in their partnership agreement. Truly, the partnership agreement is the cornerstone of a Delaware limited partnership, and effectively constitutes the entire agreement among the partners with

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<sup>160</sup>See DEL. CODE ANN. tit. 6, § 18-1101(b) (1999) (emphasis added).

<sup>161</sup>DEL. CODE ANN. tit. 6, § 18-1101(b) (1999).

<sup>162</sup>Lubaroff & Altman, *supra* note 153, § 20.4.

respect to the admission of partners to, and the creation, operation and termination of, the limited partnership. Once partners exercise their contractual freedom in their partnership agreement, the partners have a great deal of certainty that their partnership agreement will be enforced in accordance with its terms.<sup>163</sup>

The private ordering potential, limited liability, and favorable tax treatment aspects of the LLC have led it to be described as the "hot" business form and the "entity of choice" for the future.<sup>164</sup>

### III. LIKELY DEVELOPMENTS FOR THE TWENTY-FIRST CENTURY

#### A. *Predictions Regarding Technology and Globalization*

Having reviewed the current trends in technology and globalization effecting corporate governance, it is not at all difficult to make the following predictions:

##### 1. Technology

- Efficient capital markets will continue to steer money toward emerging technologies.
- Technological advances will continue to facilitate the capital markets. Specifically, more and more companies will use the Internet to raise money, and eventually, a substantial portion of all investing will be done on-line, directly by investors.
- Electronic commerce will explode, with companies eventually conducting almost all of their business-to-business transactions electronically, and a majority of their consumer business electronically. Consumers will never, however, completely forfeit their fascination with mall shopping.
- Corporate governance practices including notice, voting and meeting attendance will evolve to keep pace with technological

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<sup>163</sup>See *Elf Atochem N. Am.*, 727 A.2d at 291 (quoting MARTIN L. LUBAROFF & PAUL ALTMAN, DELAWARE LIMITED PARTNERSHIPS § 1.2 (1999) (footnote omitted)). Clearly, both the LP Act and the LLC Act are uniform in their commitments to "contractual flexibility." See Lubaroff & Altman, *supra* note 153, § 20.4.

<sup>164</sup>Copperthwaite, *supra* note 156, at 238-39.

advances, so that the law mirrors the everyday communication practices of the market.

## 2. Globalization

- Globalization of the economy and economic interdependence among all countries will intensify in the next century.
- Additional European countries, including former Eastern block countries, will eventually join the European Union and adopt the euro as currency.
- The euro will gain the international esteem of the yen and the dollar.
- There will be pressure to establish one world-wide trading unit.
- Stock exchanges will go global, and there will be cross-listing potential across international stock exchanges. Eventually, there may be a consolidation among the major stock exchanges.
- Small companies from third world countries will be able to use the Internet to even the playing field (almost).
- Boundaries will no longer be based on geography, but on buying preferences.
- Institutional activism, in whatever form it continues to exist, will cross international boundaries.

### *B. Predictions Regarding Corporate Monitoring and Private Ordering*

Predictions about corporate monitoring and private ordering are a little more complicated. Do current corporate monitoring trends, such as outside directors and institutional investors, signal the beginning of the end of Berle-Means' separation of ownership and control; or do they constitute additional reasons why corporations of the twenty-first century will likely favor a universal entity that allows virtually unlimited private ordering? The authors submit that the latter is more likely.

## 1. Corporate Monitoring

Institutional investors, who have currently increased their activities in corporate monitoring, will forego any attempts to micro manage business entities in favor of opportunities for higher returns sponsored by worldwide promoters. Even if these investors do seek certain safeguards on the activities of the managers, these safeguards will be the product of arms length negotiated contracts, rather than demands for further accountability by regulation.

Assuming relationships are structured in advance via contract, unitholders may be willing to cede virtually complete control to corporate promoters, in exchange for higher rates of return. Part of the contractual bargain struck at the beginning, in exchange for this complete control, however, would require management to meet certain performance objectives. If those performance objectives were not met within a specified period of time (and not renegotiated), then unitholders would be contractually entitled to intervene as they see fit.

## 2. Private Ordering

Corporate promoters are tired of people looking over their shoulders, and are anxious to compete in a lightning-quick, competitive, global market. They will likely seek a new business form that affords them maximum flexibility. A uniform entity that expands the LLC concept even further will emerge to meet these promoters' needs.

The universal entity will have a simple form. It will be remarkable for its rejection of statutory and common law definitions of stakeholder relationships in favor of contractual ones. Those seeking to raise capital will not wish to be bound by layers of law, regulatory and statutory requisites, or fiduciary duty concepts. They will want total freedom of contract to structure their particular deal, their particular ownership and debt instruments and the exact nature of accountability without concepts such as fiduciary duty, corporate opportunity, or entire fairness. As the late Judge Friendly once observed, "[T]he business of business is business."<sup>165</sup> It is not regulation or fiduciary doctrine.

Unitholders will be willing to cede virtually all control in exchange for higher rates of return. A universal entity contract, specific to each company, will structure all stakeholder relationships. It will define the nature and extent of fiduciary duties (if any). It will govern all aspects of forms of ownership and distributions. It will allow maximum flexibility in

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<sup>165</sup>Judge Henry Friendly, Address at an LPI lecture (quoting a popular axiom).

creating and structuring all types of financial instruments. It will structure all aspects of meetings, elections, voting, and notice. Indeed, it may eliminate all meetings or elections, if the promoters so choose. Conflicts will be resolved by interpreting the contract among the unitholders. Members will be judged not by reference to statutory or fiduciary standards, but rather by their adherence to the contract.

Furthermore, the interdependence of international economies and markets will eventually require entities to have international cross-over abilities. Indeed, successful raising of capital in the future will depend on it. Accordingly, the uniform entity will be allowed to conduct business not only across local jurisdictions, but across international jurisdictions as well.

The jurisdiction that creates, sustains, and supports this universal entity will not only be the corporate governance leader in the twenty-first century for this country, but also for the world.

#### IV. CONCLUSION

As Professor Joseph A. Grundfest has observed: "[M]odern financial markets cross national borders with ease. Chameleon-like, they can generate novel instruments and transactions that capitalize on changes in legal regimes."<sup>166</sup> These capital markets have already begun to adapt and will continue to adapt to the technological advances and globalization of the economy prominent today and likely to continue, indeed expand, into the future. Corporations that wish to compete will likewise need chameleon-like qualities in order to adapt to the ever-changing capital markets. To do so, they will need to position themselves, in order to control their own destinies. The likely evolution of a simple, universal entity that enables maximum private ordering will enable corporations to do just that.

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<sup>166</sup>Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J., 387, 391 (1992).