Altering Rules: The New Frontier for Corporate Governance

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Abstract. Should corporations enjoy total contractual freedom to design their governance? This question lies at the foundation of corporate law scholarship. Its practical relevance has been limited, however, because the mandatory status of corporate law's most important rules were never in doubt.

Until now. The leading authorities on corporate law—Delaware's courts—are increasingly asked to enforce shareholder agreements that seek to contract around the very core of corporate law's rules, including the fiduciary duty of loyalty and the central role of the board. The courts have responded by largely authorizing these experiments, and where they have limited contractual freedom, the Delaware legislature has stepped in to broaden it. A foundational debate has thus returned to the fore by force of transactional innovation: What limits, if any, should there be on corporations' freedom to restructure their governance?

We develop a new approach to this question, and in doing so, make three main contributions. First, we show why the new version of the mandatory rules debate is different. The original debate posed the question of mandatory rules within a specific paradigm of opt out—most prominently exemplified by a charter amendment in a public company. The current case law almost invariably addresses opt out in the setting of a shareholder agreement. This is not merely a shift in legal technicalities or governing jurisprudence; it represents a fundamental shift in corporate law's *bargaining paradigm*. Shareholder agreements, when unanimous, raise a powerful inference of Pareto efficiency; even when the parties are only a subset of shareholders, they raise distinctive questions of whether their effects on other insiders can be managed. More broadly, the rise of shareholder agreements should force us to ask whether corporate law has fully grappled with its altering rules, both actual and potential, and how they differ in their fundamentals.

Our second contribution is to develop a theory of altering rules for corporate law. In standard contract situations, all parties must consent to a contract and are bound by its terms. The defining challenge for corporate altering rules is to determine which parties (such as a majority of directors, or of shareholders, or both, or each shareholder individually) should be empowered to make decisions that can directly bind and invariably affect a broader group. Every "opt out" mechanism, both the familiar ones (charter, bylaws, shareholder agreement) and unfamiliar ones, shares these two elements: (1) process (who is empowered to make decisions about governance) and (2) scope (who is bound by it). To illustrate the utility of our theory, we propose a new class of altering rules: *compound* altering rules, which authorize a shareholder-specific change to governance only where a firm-wide process authorizes such contracting.

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Lastly, we return to the central normative question of the place of mandatory rules in corporate law. We suggest that there should be no *inherent* substantive limits on what corporations can do to alter their governance. Instead, the limitations should arise from the design of the *altering rules* that govern how corporations can change default rules. Every rule can be a default—provided the altering rule is carefully designed. This position is not as radical as it may seem. Given appropriate altering rule design, many rules will remain de facto mandatory, particularly in public firms. But for us, the key inquiry is not *whether* a corporation can opt out of a rule of corporate law, but *how*. Contractual innovation in corporate governance is a new frontier for the study and practice of private ordering.

Contents

A. Introduction

Should corporations enjoy total contractual freedom to restructure their governance? Or should some rules of corporate law be mandatory? If so, which ones, and why? These are among the foundational questions of corporate law and theory,[2] yet the debate has been largely academic. This is because the most important rules in corporate law—including fiduciary duties, certain stockholder rights, and the central managerial role of the board—have been mandatory for more than a century.[3] As a practical legal matter, that status has been rarely challenged.

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[2] Perhaps the best known version of this debate was a seminal Columbia Law Review symposium in 1989. We will have more to say on some of the positions from that symposium later. See, e.g., Lucian Arye Bebchuk, Foreword: The Debate on Contractual Freedom in Corporate Law, 89 Colum. L. Rev. 1395 (1989); Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 COLUM. L. REV. 1416 (1989); Lewis A. Kornhauser, The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel, 89 COLUM. L. REV. 1449 (1989); Melvin Aron Eisenberg, The Structure of Corporation Law, 89 COLUM. L. REV. 1461 (1989); Ralph K. Winter, The Race for the Top Revisited: A Comment on Eisenberg, 89 COLUM. L. REV. 1526 (1989); Fred S. McChesney, Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg, 89 COLUM. L. REV. 1530 (1989); Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 COLUM. L. REV. 1549 (1989); Roberta Romano, Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws, 89 COLUM. L. REV. 1599, 1601-02 (1989); John C. Coffee Jr., The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 COLUM. L. REV. 1618 (1989). *See also* Jonathan R. Macey, *Corporate Law and Corporate Governance: A Contractual Perspective*, 18 J. Corp. L. 185 (1992); Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp & Mark D. West, *Innovation in Corporate Law*, 31 J. Comp. Econ. 676 (2003); Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 Harv. L. Rev. 833 (2004); Jens Dammann, *The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law*, 65 Hastings L.J. 441 (2013); Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. Empirical Legal Stud. 31 (2017); Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gérard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe & Edward Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford Univ. Press 2017); Gabriel Rauterberg & Eric Talley, Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers, 117 Colum. L. Rev. 1075 (2017); Sarath Sanga, *A Theory of Corporate Joint Ventures*, 106 Calif. L. Rev. 1437 (2018) (on contracting between corporations). Some scholars have argued that the status of a rule as "default" or "mandatory" does not even matter. See Bernard S. Black *Is Corporate Law Trivial: A Political and Economic Analysis*. 84 Nw. UL Rev. 542 (1989).

[3] Indeed, many major developments in corporate law, especially those involving the enforcement of fiduciary obligations, can be interpreted as attempts to enable new kinds of transactions and governance structures whilst respecting this inviolable core. Manti v. Authentix (Del. 2021) at 29 ("At its core, the DGCL is a broad enabling act that allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise *provided* the statutory parameters and judicially imposed principles of fiduciary duty are honored.") (emphasis added; quotations and alterations omitted). There are countless examples: DGCL 144 enables interested (i.e., conflicted) transactions but subjects them to a potentially onerous authorization process and standard of review. This rule does not eliminate a director or officer's fiduciary duty of loyalty (which would obligate them not to make decisions that further their own interests over the corporation), but instead provides a path for pursuing a potentially beneficial transaction in spite of the conflict. Similarly, Kahn v. M&F Worldwide Corp. (Del. 2014) enables controller takeovers without entire fairness review provided certain procedural protections are in place. Perhaps the most notorious episode is the case of Smith v. Van Gorkom (Del. 1985) and the legislative response, DGCL 102(b)(7). In *Van Gorkom*, the Delaware Supreme Court held a board personally liability for breach of the fiduciary duty of care in connection with a sale of the company; in 102(b)(7), the Delaware legislature enabled corporations to avoid outcomes like *Van Gorkom* by adopting a charter amendment eliminating directors' personal liability.

Until now. A new wave of corporate governance practices—and the resulting litigation—has both revived and changed the terms of the debate. The leading authorities on corporate law—Delaware's courts—are increasingly asked to enforce shareholder agreements that seek to contract around the very core of corporate law's rules.[4] Whispers of these cases can be heard as far back as the early 2000s, with courts suggesting shareholders could waive their statutory rights to inspect books and records or to remove directors.[5] But those whispers have since reached a crescendo. There are many recent examples, but three cases—*Manti* (2021), *Fugue* (2023), and *Moelis* (2024)—can usefully illustrate. In each case, stockholders sought to challenge the mandatory status of corporate law by directly contracting around statutory rights and fiduciary protections that, until then, were commonly believed to be mandatory. In each case, parties ultimately succeeded. In the first two cases, the courts authorized stockholders, under certain procedural circumstances, to waive their statutory right to an appraisal (*Manti*[6]) and their common law right to sue for breach of fiduciary duty (*Fugue*[7]). In the third case of *Moelis*, the Chancery Court held that shareholders cannot contract around the centerpiece of Delaware's corporate statute—Section 141(a)—which enshrines the board-centric model of governance. Yet within weeks of that ruling, the corporate bar proposed legislation overturning *Moelis*, which was ultimately adopted by the Delaware legislature. Under the new statutory provision, boards can delegate to shareholders their core decision-making powers by contract to the same extent they could have done so by charter.[8] An evergreen debate has thus returned to the fore by force of transactional innovation: What limits, if any, should there be on corporations' freedom to contract over governance?

In this paper, we develop a new approach to these questions, and in doing so, make three main contributions. First, we show why the new version of the mandatory rules debate is different. When this issue was given serious attention in the 1980s, a specific paradigm was the focus of the debate. First, the focus was on large public companies, where dispersed shareholders with limited attention have few opportunities to challenge incumbent management. Such companies face the classic corporate agency problem—the separation of ownership from control[9]—compounded by the problem of highly dispersed and rationally apathetic owners. More crucially, the debate centered on a specific mechanism

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[4] *See also* Gladriel Shobe & Jarrod Shobe, The Dual-Class Spectrum, 39 Yale J. Reg. 1286, 1288 (2022); Ann M. Lipton, The Three Faces of Control, 77 Bus. Law. 801, 803 (2022) ("corporate control rights are increasingly allocated in unique and idiosyncratic ways").

[5] See, e.g., Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113, 125 (Del. Ch. 2000) (suggesting that shareholders might be able to contractually waive their statutory right to inspect a corporation's books and records, but also holding that "[t]here can be no waiver of a statutory right unless that waiver is clearly and affirmatively expressed in the relevant document").

[6] Manti Holdings, LLC v. Authentix Acquisition Co., 261 A.3d 1199, 1216 (Del. 2021) ("Sophisticated and informed stockholders can voluntarily agree to waive their appraisal rights in exchange for valuable consideration").

[7] New Enterprise Associates 14, L.P., et al. v. Rich, et al. [Fugue], 2023 WL 3195927 (Del. Ch. May 2, 2023).

[8] See Delaware Corporate Law Section's proposed amendments to DGCL 122(18).

[9] The canonical origin of this discussion comes from the treatment by Adolf Berle and Gardiner Means. Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (1932).

for "opting out" of corporate law–amending the corporate charter–and to a lesser extent on bylaw amendments initiated by the board and proposals from shareholders.

But in recent decades, a new frontier of corporate governance has emerged: the shareholder agreement.[10] Unlike traditional mechanisms, this option allows all or a subset of shareholders to contract among themselves to modify governance rules. These agreements may also involve directors, officers, the corporate entity, and even third parties, adding layers of complexity to the governance structure. Though a longstanding feature of closely-held firm governance, shareholder agreements have grown into a powerful yet controversial tool, particularly in venture capital and private equity-backed companies. The current case law struggling with mandatory limits almost invariably addresses opt out in the setting of a shareholder agreement. The evolution in shareholder contracting has thus reframed the key questions: rather than asking which rules corporations can alter by charter or bylaws, we must now ask which rules can be modified by contract. This is not a mere shift in legal technicalities or governing jurisprudence; it represents a fundamental shift in how opt out occurs.

The reason lies in the structure of the *bargaining process*. The traditional routes of governance changes are, at root, either unilateral decisions or take-it-or-leave-it offers. Board-initiated bylaw amendments are typically unilateral decisions taken by the board. Similarly, shareholder proposals are initiated by one or more corporate owners. In public companies, even charter amendments and other fundamental changes such as mergers are typically take-it-or-leave-it offers proposed by the board and accepted or rejected by shareholders.[11] Do shareholder agreements in large private companies and even public ones share these characteristics? Often they will not. Instead, a shareholder contract can be the product of a genuine bargaining process. The result is not just a more equitable split of the pie—but a larger pie. When all parties get a substantial share of the surplus, all sides are incentivized to innovate and improve the quality of the deal. This *possibility* is a primary part of the case for expanding corporations' freedom to change the rules of governance.

Whether this possibility will in fact obtain depends largely on the rules that govern the bargaining process itself—that is, on the *altering rules*. Altering rules are the rules specifying how parties can opt out of the default rules of law. They are basic building blocks of private ordering. Yet corporate law does not have a systematic theory of its own altering rules. This brings us to the second contribution of this article.

We develop a theory of altering rules in corporate law. The goal of our theory is to explain the distinctive challenge of altering rules in corporate law, the basic components of corporate law's altering rules, and the primary functional considerations relevant to choosing amongst them. We begin by distinguishing

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[10] Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 Yale J. Reg. 1124, 1131 (2021); Robert B. Thompson, *Private Ordering and Contracting Out in Twenty-First-Century Corporate Law*, 74 Case W. Rsrv. L. Rev. 13 (2023).

[11] For an incisive analysis of these bargaining features in public firms, *see* Ryan Bubb, Emiliano Catan & Holger Spamann, *Shareholder Rights and the Bargaining Structure in Control Transactions* (2024).

the altering rules of corporate law from those found in standard contractual settings. In the standard model, restraints on contractual freedom are justified on two bases: paternalism and externalities.[12] That is, mandatory rules are justified either by a need to protect the signatories to the contract who are seeking to modify the rules (paternalism) or to protect parties outside of the contract who are affected by it (externalities).[13] But corporate law foregrounds a third dimension: the need to protect parties *outside* the contract but still *inside* the corporation. For example, when two stockholders form a voting agreement, their contract impacts not just themselves (giving rise to paternalism concerns) or third parties outside of the corporation (giving rise to externality concerns), but also *other insiders to the corporation*. When a charter amendment is made, it is seldom unanimous, while a board-adopted bylaw forgoes the consent of shareholders altogether. Unanimity among all insiders is the corner case; the distinctive challenge of altering rules in corporate law is to address the fact that a process must be designed whereby some insiders will make decisions that affect other insiders. We refer to the effects of these decisions as intra-corporate impacts, a broad term encompassing all the ways in which the corporate insiders' conduct affects the economic value of other insiders' interests in the firm.

The existence of intra-corporate impacts distinguishes shareholder contracts from other contracts. The reason is straightforward: unlike in contract, corporate law's altering rules generally do not require unanimous consent. But in a corporation, unanimity is usually impracticable. Typically, only a subset of the corporation's owners and managers need consent to changes in corporate governance. Consent might come from a majority of the board of directors,[14] or a majority of shareholders,[15] or either one,[16] or only both together,[17] or a subcommittee of directors,[18] or a supermajority of shareholders,[19] or only all shareholders,[20] or only each shareholder individually.[21] Sometimes, those who are bound by the new

[12] See, e.g., Ayres, supra note __, at 2032.

[13] *Id*.

[14] Through a bylaw amendment, but that first requires that in the corporation's certificate of incorporation it conferred "the power to adopt, amend or repeal bylaws upon the directors." Del. Code Ann. tit.t 8, § 109(a).

[15] Del. Code Ann. tit. 8, § 109(a).

[16] *Id.*

[17] Del. Code Ann. tit. 8, § 242(b).

[18] Del. Code Ann. tit. 8, § 141(c).

[19] Charters can adopt supermajority rules, *see* Del. Code Ann. tit. 8, § 216.

[20] Shareholders cannot ratify corporate waste without a unanimous vote. *Lewis v. Vogelstein*, 699 A.2d 327, 335 (Del. Ch. 1997) ("it has long been held that shareholders may not ratify a waste except by a unanimous vote"). *See also*, *Saxe v. Brady*, 184 A.2d 602, 605 (Del. Ch.1962) ("Approval by a mere majority of stockholders does not ratify waste.").

[21] As an example of such a voting block requirement, though not in the context of an altering rule, during Mark Zuckerberg's attempted recapitalization of Facebook's non-voting shares, he needed to amend the charter. This required the action to pass a majority vote of the minority shareholders, which he ultimately failed. A similar logic applies to the question of who is bound by such altering rules. The default standard by which a court will review an interested transaction between a director and the corporation is "entire fairness." It can be altered for a specific director if the other (disinterested) directors approve the transaction ex ante. Such approval, however, naturally applies only to the one director (and not to other directors or other transactions).

rule are not the same as those who gave their consent. Shareholders, for example, can change the rules that apply to directors, and vice versa.[22]

Those who *decide* whether to displace a default rule of corporate law are often not the same as those who are *bound* by the new rule. Depending on the altering rule, the overlap between these two groups may be complete, partial, or nonexistent. Both "those who decide" and "those who are bound" are defined by the altering rule itself, and so for us they constitute a corporate altering rule's essential features. We refer to the decision-making group as an altering rule's *process*, and the group that is bound as an altering rule's *scope*. Empowering corporations to displace default rules thus requires lawmakers and firms to make deliberate choices along these two dimensions.

How should lawmakers and firms design their altering rules? We take the primary challenge of altering rule design in corporate law to be mitigating the intra-corporate effects of insiders exercising contractual freedom. For a shareholder contract, the inference of Pareto optimality among the signatories is strong, and the costs of opportunism are likely to be borne by the non-signatories. We illustrate how these effects can be managed by focusing on the possibilities of altering rule design.

One of the benefits of identifying these essential features, and more generally to articulating a theory of corporate law's altering rules, is that it illuminates the broader landscape of corporate law's *potential* altering rules. This landscape is much richer than either courts or scholars have recognized. As one example, we propose a new class of altering rules specifically designed to manage the limits of corporate contractual freedom. Instead of asking courts or the legislature to enable (or disable) certain persons from contracting around a given rule (as is the current approach), we propose an altering rule that would enable certain shareholder contracts—provided that some other internal governance instrument (either the charter, the bylaws, or a board resolution) authorizes stockholders to form them. We refer to such rules as *compound altering rules* because they combine two governance instruments: a contract along with one other instrument. The advantage of a compound altering rule is that it (1) transfers the decision-making onus over whether to permit contractual freedom from the courts and legislature (which will tend toward a one-size-fits-all approach) to each corporation, but also (2) establishes a framework for managing intra-corporate impacts (by requiring broader authorization from a second governance instrument). Put another way, the advantage of a compound altering rule is that it promotes both contractual innovation and fiduciary protection.

To illustrate, turn to *Fugue*. Since it was issued, the major criticism of the decision has been that it ignores the intra-corporate effects of a waiver because a shareholders' decision to forgo their right to enforce the duty of loyalty affects the value of other shareholders' interests.[23] We concede that point. Yet a

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[22] To give two simple examples: a majority of board members can displace a default that binds all stockholders by amending the bylaws; a majority of stockholders can similarly bind all stockholders by amending the bylaws. There are countless others. *See* ___ *infra*.

[23] *See, e.g.*, Fisch, Appraisal, Iowa L. Rev.

compound rule could substantially or completely accommodate this concern by making an individual shareholders' right to waive suit only enforceable subject to a charter provision or majority stockholder vote authorizing individual shareholder waivers. The possibility of a compound rule here illustrates our main policy claim, namely, that more creative altering rule design weakens the case for substantive mandatory limits on corporate contractual freedom.

Lastly, we return to the central normative question of whether there should be mandatory limits on corporation's freedom to tailor their governance. We suggest that there should be no *inherent* substantive limits on what corporations can do to alter their governance. Instead, the limitations should arise from the design of the altering rules that govern how corporations can change default rules. Every rule can be a default—provided the altering rule is carefully designed. Our intention is to change the focus of the debate. For us, the key inquiry is not whether a corporation can opt out of a rule of corporate law, but how. In our view, the case for mandatory rules in corporate law substantially weakens once one appreciates the richness of the full set of altering rules available to courts in guiding corporate innovation.

The article proceeds as follows. Part I summarizes the shift in Delaware case law toward contractual governance. Part II explains why shareholder agreements represent a distinct mechanism for contracting out of corporate law, particularly in comparison to the traditional route of a charter amendment. Parts III and IV lay out our theory of corporate law altering rules. Part V explores the legal and normative implications by applying our theory to recent cases.

I. Delaware's Contractarian Turn

A. Beginnings

The first rumblings of Delaware's contractarian turn began twenty years ago. It involved shareholders' statutory right to inspect a corporation's books and records—a core informational right whose mandatory status is seemingly dictated by the statute's use of the word "shall."[24] But in *Kortum v. Webasto Sunroofs, Inc.*,[25] the Chancery Court suggested in dicta that a shareholder agreement could potentially contract away this right. The agreement before the court did not "expressly provide for a waiver of statutory inspection rights,"[26] yet the court suggested that shareholders could waive a statutory right if "that waiver is clearly and affirmatively expressed."[27]

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[24] DGCL § 220 (proving that "Any stockholder…shall…have the right …to inspect [the corporation's records]") *See, e.g.*, Welch & Saunders *supra* note 21 at 856.

[25] 769 A.2d 113, 125 (Del. Ch. 2000).

[26] *Id.*

[27] *Id.* at 125. See also *In re Appraisal of Ford Holdings, Inc. Preferred Stock*, 698 A.2d 973, 976 (Del. Ch. 1997) (precedent suggesting that preferred stockholders could waive their appraisal rights through a shareholder agreement).

Next, *Bonanno v. VTB Holdings, Inc.*,[28] addressed Section 115 of the DGCL, which authorizes a corporation's charter or bylaws to mandate that internal corporate claims are brought only in Delaware. That section also provides that the charter and bylaws cannot prevent shareholders from bringing internal corporate claims in Delaware. But the Chancery Court said that this did not mean that a *contract* could not prevent a shareholder from suing in Delaware court. In fact, a shareholder may contractually waive their Section 115 right to bring internal claims in Delaware.[29] Section 115, the court observed, does not alter Delaware's public policy favoring contractual freedom.[30]

The Delaware legislature has also participated in the contractual turn. It adopted statutory provisions prohibiting either the bylaws or charter from requiring that fees be shifted in litigation asserting internal corporate claims, yet it also provided accompanying commentary to the amendments emphasizing that shareholder agreements are *not* subject to these prohibitions.[31]

B. Acceleration

The last five years have witnessed a striking new set of challenges to the mandatory content of corporate law. The highest profile holding in this trend came in late 2021, when a divided Delaware Supreme Court held in *Manti v. Authentix*[32] that shareholders may contractually waive their statutory right to an appraisal.[33] *Manti* was a rare split decision, and a surprising one given that language of the statute again provided that stockholders "*shall* be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock."[34] The losing side offered a slippery slope argument against the majority's holding: If stockholders could waive their appraisal rights, then could they also waive "their statutory right to seek books and records under Section 220, their ability to challenge an election under Section 225, their ability to bring an action to compel a stockholders' meeting under Section 211, [] their ability to file a breach of fiduciary duty action"[35]—and any other statutory right that uses the word

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28 2016 WL 614412 at *15 (Del. Ch. Feb. 8, 2016).

29 *Id*.

30 The court noted that the bill's synopsis suggested that the legislature did not intend "to prevent the application of [a] provision in a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced." *Id.* (quoting S. 75 syn., 148th Gen. Assemb. § 5 (Del. 2015) ("Synopsis")).

31 S. 75 syn., 148th Gen. Assemb. §§ 2, 3 (Del. 2015) (noting that neither Section 109(b), nor Section 102(f) was "intended . . . to prevent the application of such provisions pursuant to a stockholders agreement or other writing signed by the stockholder against whom the provision is to be enforced").

32 261 A.3d 1199, 1216 (Del. 2021).

33 *Id.*

34 8 Del C. § 262(a) (emphasis added).

35 *Manti*, 261 A.3d at 1204-05. This trend has not been without its critics. Perhaps the most outspoken has been Professor Jill Fisch. See Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L.Q. 913, 914 (2021); Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 390-92 (2018); Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1638 (2016). See also Jill E. Fisch, *A Lesson from Startups: Contracting Out of Shareholder Appraisal*, 107 IOWA L. REV. 941, 942 (2022). In this paper, Jill Fisch argues that the functional role of appraisal waivers lies primarily in shaping a governance ecology, rather than in serving as an individual right for shareholders. As a result, she argues that waivers should be permitted, but only in a

"shall."[36] The majority brushed aside with a theory to distinguish the appraisal right from other features of the corporation. The theory posited that each feature of the corporation—whether a structural concept or a statutory right—was either "fundamental" or "not fundamental." (Precisely where this distinction comes from is hard to say.) It then found that the appraisal right in Section 262 was of the "not fundamental" variety, and thus waivable.[37]

C. Zenith

Two recent cases, *Fugue* (2023) and *Moelis* (2024), together mark the zenith of Delaware's contractarian turn. In *Fugue*, the Court of Chancery held that stockholders may, provided certain circumstances are met, waive their right to sue for breach of fiduciary duty. In *Moelis*, however, the Court of Chancery partially invalidated a stockholder agreement that gave the CEO and founder, Ken Moelis, veto rights over almost every corporate decision of consequence, including over whom to recommend to stockholders for election to the board. [38] In the *Moelis* opinion, the court reasoned that, while many of the rights may individually be lawful and even commonplace, collectively they went too far.[39] A corporation cannot cede that much governance power without running afoul of the centerpiece of Delaware's corporate law statute: DGCL Section 141(a), which famously enshrines Delaware's board-centric model of corporate governance. More broadly, *Moelis* suggested that there *is* a limit to the stockholders and the corporation's power to contract around Delaware's core.

Together, these cases signaled both an increase in corporate contractual freedom (*Fugue*) but also a potential set of limiting principles (*Moelis*). But the existence of those limits was immediately put into doubt. Only weeks after the Chancery's *Moelis* opinion was released, the Council of the Corporation Law Section[40] of the Delaware State Bar Association released—and then immediately revised—a draft of proposed amendments to the DGCL ("Amendments") designed to overturn *Moelis*. The Council regularly reviews and proposes amendments to Delaware's corporate law statute, and its proposals are just as regularly adopted. Its original proposal would have permitted not just the kind of contract invalided in *Moelis*, but seemingly *any* contract involving the corporation.[41]

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corporation's charter. We strongly agree that governance in general creates intra-corporate effects. However, we view the right response to this reality as lying in reimagining a broader set of altering rules.

36 As it turns out, the Delaware Chancery Court had already entertained or endorsed the waiver of two of these four rights, while the right to sue for breach of fiduciary duty would follow two years later, in *Fugue*.

37 *Id.* at 1204 ("Section 262 does not prohibit sophisticated and informed Stockholders, who were represented by counsel and had bargaining power, from voluntarily agreeing to waive their appraisal rights in exchange for valuable consideration").

38 *Complaint for Declaratory Relief* at 2. *Moelis,* No. 2023-0309, 2023 WL 4637069, (Del. Ch. March 13, 2023).

39 *Moelis* at 7-8.

40 The Council regularly reviews and proposes amendments to Delaware's corporate law statute, and its proposals are just as regularly adopted.

41 The proposal would authorize corporations to:

> Make contracts with one or more current or prospective stockholders..., [in which] the corporation may agree to:
>
> (a) restrict or prohibit itself from taking actions specified in the contract,...

Following criticism from us and others,[42] the Council revised its proposed amendment. The now-adopted amendment focuses specifically on the kind of contract at issue in *Moelis*. It expressly empowers the board to contract away its powers under DGCL 141(a) to a stockholder, *provided* that the same provision could have been included in the charter. In this way, the revised proposed amendment can be thought of as a relaxation of an altering rule: whereas certain reallocations of corporate power could only be accomplished through a charter amendment, they can now be adopted through a contract with a shareholder.[43]

Since *Fugue* is a centrally motivating case for our theory of altering rules, it is worth going into it in a little more detail. The case featured a cloud security company (Fugue) which was backed by a number of private funds, including funds managed by leading venture capital firms. After unsuccessfully looking for an acquirer, the company sought new financing. When the funds declined to provide it, the company instead sought a recapitalization led by a new investor, George Rich. As a condition of his investment, Rich asked the other shareholders to agree that if he later led a sale of the company, they would not sue him for breach of fiduciary duty.[44] The other shareholders agreed, a subsequent sale occurred, and the other shareholders sued for fiduciary breach anyway. They argued that their agreement not to sue was facially invalid because fiduciary duties, and specifically the duty of loyalty, are mandatory rules.

In an exceptional opinion, Vice Chancellor Laster disagreed, and held that a written agreement not to sue for breach of fiduciary duty is enforceable provided it (1) is "narrowly tailored" to a specific transaction and (2) passes a catch-all reasonableness test turning on the explicit, specific, clear, and bargained-for nature of the exchange and the sophisticated, repeat players involved.[45] The court

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(b) require the approval or consent of one or more persons or bodies before the corporation may take actions specified in the contract…, and

(c) covenant that the corporation or one or more persons or bodies will take, or refrain from taking, actions specified in the contract…

Simply put, the Amendment would empower a corporation to agree to (a) not do something, (b) do something only with permission, and (c) make sure something is done (or not done).

42 Sarath Sanga & Gabriel Rauterberg, *Proposed Amendments to DGCL on Stockholder Contracting Would Create More Problems Than They Purportedly Solve*, Harv. Corp. Gov. Blog (Apr. 5, 2024), https://corpgov.law.harvard.edu/2024/04/05/proposed-amendments-to-dgcl-on-stockholder-contracting-would-create-more-problems-than-they-purportedly-solve/.

43 For analysis of the revised proposed amendment, see Marcel Kahan & Edward Rock, *Proposed DGCL § 122(18), Long-term Investors, and the Hollowing Out of DGCL § 141(a)*, Harv. Corp. Gov. Blog (May 21, 2024); Lucian A. Bebchuk, *The Perils of Governance by Stockholder Agreements*, Harv. Corp. Gov. Blog (May 21, 2024).

44 More specifically, Rich's proposed investment required the funds to agree to a series of changes to Fugue's governance and capital structure. This included the execution of a shareholder agreement. That agreement contained a drag-along right providing that if the board and a majority of preferred stockholders approved a sale of the company then the signatories must also participate. Crucially, the agreement's signatories also committed not to sue Rich or his affiliates over that sale, including over any breach of the duty of loyalty.

45 *Fugue*, 295 A.3d at 589-90.

permitted opt out, but conditioned it explicitly on the nature of the bargaining process involved. We refer to these conditions and factors as the *Fugue* doctrine. By our reading, the *Fugue* doctrine amounts to a "supra-contractual" altering rule because it is an extreme version of the usual consideration and offer/acceptance elements of contract formation.[46]

The argument in *Fugue* begins by recognizing the foundational nature of the case. The duty of loyalty is the single most important concept in corporate law.[47] It is the foundation of a rich collection of anti-conflict doctrines, and thus the font of most impactful corporate litigation. The duty of loyalty regulates virtually every aspect of corporate life: ordinary course transactions, mergers and acquisitions, regulatory compliance, director elections, executive compensation, and more. Without it, so the standard argument goes, opportunistic managers could self-deal and engage in conflicted transactions that benefit themselves at the expense of shareholders. That's bad for business.

Yet the problem with this argument is that it seemingly rests on a paternalistic rationale. It only works if shareholders are unable to look after their own interests. That may be true for some corporations, especially public ones where small, passive, and "rationally apathetic" shareholders abound.[48] But many corporations have only a handful of shareholders, each sophisticated and lawyered-up and able to look after themselves. Such shareholders should be able to bargain away their corporate rights—provided they can sufficiently demonstrate their sophistication to the court. This, in a nutshell, was the Court of Chancery's argument in *Fugue*.[49]

Fugue itself authorized a relatively narrow stockholder contract—and yet for us *Fugue* signals one of the most fundamental changes in corporate law jurisprudence of the last century. By its own terms, *Manti* applied to a single specific statutory right (the appraisal right). *Fugue*, on the other hand, provides recipe for contracting out of fiduciary duties (under specific and pre-specified circumstances). Of course, the Delaware Supreme Court could overturn it. Or it may interpret it narrowly, and thus limit it to narrow settings such as drag-along deals or specific kinds of strike suits.[50] But if interpreted according to its own terms, *Fugue* could unleash a new era of corporate governance, one that is principally driven less by

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46 One immediate objection to this interpretation is worth noting—and rejecting. True, the court did not say a controller could waive the duty of loyalty. It only said that stockholders could waive their right to sue for breach of the duty. Further, since the corporation itself was a not a party to the contract, the board of directors could still enforce the duty by suing the controller. This is a senseless objection because controllers often dominate the board (either because they have the voting power to appoint directors or the persuasive power to control their votes). For practical purposes, eliminating minority stockholder's right to sue a controller is as good as eliminating everyone's right to sue a controller.

47 *See* Rauterberg & Talley, *supra* note 23.

48 Even this concern need not justify a mandatory rule. McDonnell argues instead that "imperfectly efficient markets and collective action and rational apathy problems" that raise concerns "that shareholders in public corporations may agree to rules that hurt their interests," may instead be accommodated by sticky defaults. McDonnell, *supra* note 9, at 400.

49 295 A.3d 520, 593 (Del. Ch. 2023) ("Sophisticated repeat players consented explicitly to a clear provision in a stockholder-level agreement that applies only to a specific transaction.").

50 *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884 (Del. 2016).

courts and legislatures, and more by private actors and contractual innovation.[51] For this reason, corporate law needs a theory of contracting. The next two parts provide one such theory.

II. The Rise of Shareholder Agreements

Our paper is motivated by the rise of shareholder contracting—a phenomenon that was almost completely absent from early debates on altering and mandatory rules in corporate governance. At the time, shareholder contracts were neither as prevalent nor as salient in legal disputes. This led scholars and practitioners to focus on traditional mechanisms of altering governance used in the public firms of the time. As we will argue in this section, the prevalence of shareholder contracting changes the terms of the debate by expanding the options for corporate contracting and the attractiveness of contractarianism.

In the late 1980s, the place of mandatory rules in corporate law was vigorously explored.[52] Moreover, the participants in that debate keenly appreciated that two fundamental issues were closely related: the place of mandatory rules and the issue of how corporations would opt out. Yet a single mechanism for opting out was understandably the focus of debate—the charter amendment.[53] The focus on the charter amendment was understandable. Shareholder contracting was largely under the radar, and large public firms primarily altered the fundamentals of their governance by amending their charter.

Even at the origins of the debate, scholars acknowledged that the case for contractual freedom depended on the timing, and specifically whether the rules were being changed at the moment the corporation is

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51 *Fugue* also improves on the wobbly logic of the only recent Delaware Supreme Court case on point: *Manti*. Recall that *Manti* held that shareholders could waive their statutory right to an appraisal, in spite of the statute's use of the word "shall" (which seemingly signals a mandatory rule). *Fugue* instead homes in on the altering rule and dispenses with the ad-hoc and under-theorized distinction between "foundational" and "non-foundational" features of the corporation. It also clarifies the precise requirements for effectively altering a default rule by contract.

52 Alongside the entries in the Columbia Law Review Symposium, see especially Gordon and Bebchuk, there were a number of other major contributions on the subject. See Bebchuk, Limiting Contractual Freedom in Corporate Law; Bebchuk, Freedom of Contract and the Corporation; Coffee, No Exit; Gilson. See also Comments from Symposium, Macey, Courts and Corporation: A Comment on Coffee. This article is primarily aimed at persuading proponents of mandatory rules that the case for inherent limits has weakened or must adapt in the face of the different contracting technologies now in use. But even long-time opponents of mandatory rules may appreciate that the strength of their case has changed. See Easterbrook & Fischel, *The Corporate Contract*, Colum. L. Rev; Easterbrook & Fischel, Voting in Corporate Law, 26 J.L. & Econ. 395 (1983); Easterbrook & Fischel, Corporate Control Transactions, 91 Yale L.J. 698 (1982); Fischel, The Corporate Governance Movement, 35 Vand. L. Rev. 1259 (1982). See also Macey, Insider Trading (advocating for private ordering in aspects of the securities laws that affect corporate governance); Roberta Romano, Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws, 89 Colum. L. Rev. 1599, 1601-02.

53 In writing a Foreword to the Symposium, Lucian Bebchuk framed the subject as "contractual freedom in corporate law" and the question of "To what extent should corporations be allowed to opt out of the rules of corporate law by adopting charter provisions to that effect?" See also Gordon & Romano (focusing on opportunistic use of amendments).

formed ("initial" changes) versus any time afterwards ("midstream" changes). Lucian Bebchuk, one of the most vocal defenders of mandatory rules, noted that the case for contractual freedom for initial changes is remarkably strong.[54] At the moment of formation, a corporation's governance arrangements essentially constitute a multilateral contract. Their creation is the product of unanimous consent by all parties involved. From this unanimity we may draw a critical inference: by revealed preference, the parties are all better off—otherwise, they would not have participated in the formation. Whatever changes they may have made to default rules are thus Pareto-improving, benefiting everyone and indicating that the parties have collectively chosen an arrangement that improves each of their positions.

The same inference, however, does not apply to midstream changes.[55] These changes typically do not require unanimous consent, which undermines confidence in their Pareto efficiency. In fact, the absence of unanimity suggests that a change is not Pareto-improving, and that any dissenting parties are presumably worse off. In such cases, the best one can hope for is that the changes result in a Kaldor-Hicks improvement, where the overall benefits to the corporation outweigh the harms to dissenting parties. Yet even this is not guaranteed, as majority rule (or whatever the rule may be) only approximates the collective benefit and can obscure significant disparities in how gains and losses are distributed among stakeholders.

These considerations formed the basis of early debates—but since then, the corporate landscape has dramatically evolved. Today, private companies often remain private for extended periods, raising substantial capital through multiple rounds of funding.[56] Sophisticated investors negotiate complex agreements that reflect their specific interests and concerns. This and other trends have led to a different paradigm of opt out lying at the center of the jurisprudence, namely, shareholder contracting in large companies—both private and public.

Shareholder contracts are fundamentally distinct from the traditional mechanisms of charter amendments, bylaws, and board resolutions. The difference is that, with the traditional mechanism, we can only guess that the change may (or may not) be Kaldor-Hicks improving. But with a shareholder contract, we may infer from the contract itself that the change is pareto-improving—at least so far as the contract parties are concerned. The question, then, is its impact on the non-party shareholders, or more generally the non-party insiders to the firm. We refer to these as intra-corporate impacts. Such impacts should be the principal object of interest when designing altering rules and determining the limits of corporate contractual freedom.

The fundamental difference between the charter and a shareholder agreement lies in the structure of the bargaining process. The traditional routes of governance changes are, at root, either unilateral decisions or take-it-or-leave-it offers. Board-initiated bylaw amendments are typically unilateral decisions taken by

54 Bebchuk, supra note __.

55 Lucian, supra note __ at ___.

56 Ewens & Farre-Mensa, The Deregulation of Private Equity and the Decline.

the board. Similarly, shareholder proposals are initiated by one or more corporate owners. In public companies, even charter amendments and other fundamental changes such as mergers are typically take-it-or-leave-it offers proposed by the board and accepted or rejected by shareholders.

It is a fundamental result of bargaining theory that both of these processes—unilateral decisions and take-it-or-leave-it offers—will generate extremely one-sided results. First consider a unilateral decision. Such a "process" clearly enables one group to take all of the surplus, constrained only by the formalities of law and the vagaries of the market. Market forces may discipline the decider's ability to take all the surplus, yet such forces are only as strong as our ability to promote competitive markets and overcome agency costs—both of which are far from perfect. Similarly, legal constraints such as directors' fiduciary obligations are only as good as our ability to enforce them, which is also far from perfect. Indeed, the extreme deference given to directors under the business judgment rule means that, in practice, directors are not quite obligated to represent shareholders' interests or even "split the surplus" with them, but merely need to avoid direct conflicts and refrain from self-dealing or outright looting.

Next consider the take-it-or-leave-it offer. This process is similarly designed to reach extreme results. When one side is in a position to make such an offer, the standard bargaining model predicts that that side will have 100 percent of the bargaining power and will thus obtain 100 percent of the surplus. The offeror will offer just enough to leave the offeree slightly better off (if not indifferent) compared to their outside option. Once again, the legal and market forces may practically force the offeror to give up more surplus (by improving the outside option). The fact remains, however, that the fundamental structure of the bargaining process—the take-it-or-leave-it offer—is designed to give the offeror maximal bargaining power. Thus, both unilateral decision-making and take-it-or-leave-it offers are essentially designed to produce extreme outcomes.

Not so with shareholder contracting. A shareholder contract *could* be the product of a genuine and much richer bargaining process. The result of such a process would be not just a more equitable split of the pie—but a larger pie. When all parties get a substantial share of the surplus, all sides are incentivized to innovate and improve the quality of the deal. This *possibility* is what makes the case for expanding corporations' freedom to change the rules of governance. Whether this possibility will in fact obtain in practice will depend entirely on the rules that govern the bargaining process itself—that is, on the *altering rules*.

Consider, for example, a provision eliminating directors' liability for breaches of the duty of care. Such provisions are lawful if put into a charter, which in turn requires the approval of a majority of the board and a majority of shareholders. But assume there is no such charter provision. Imagine further that some new investors are drawing up the terms of an investment in the company. One of the provisions is a promise by the new investors not to ask for money damages in any suit against directors for breach of the duty of care. This is the very thing that can be accomplished in a charter, but instead we have only a few shareholders and the board agreeing to it. Should courts enforce such an agreement?

This question—and countless others like it—are novel and remain unresolved in current legal doctrine. But from a theoretical standpoint, the argument for enforcement is strong: the involved parties have unanimously agreed to the terms, so the contract is presumably Pareto improving for those parties. But less clear is how this will impact, if at all, the non-contracting shareholders. There could be negative effects since, for example, the other shareholders are effectively losing the monitoring and disciplinary benefits that implicitly obtain when *other* shareholders can hold directors personally liable. That is, the other shareholders lose the potential positive externality of a new investor that is able to (legally) hold directors to account. Yet those same shareholders are gaining the benefits of the new investor. The purpose of corporate law's altering rules should be to enable the Coasean bargain here—if indeed there is one to be struck.

A key ambition of this article is to articulate this key problem—the intra-corporate impacts of changes to corporate governance generally—and to argue that altering rules should be designed with these in mind. We argue that shareholder contracting makes a compelling case for expanding contractual freedom in corporate governance, provided that the effects on non-participating members of the firm are adequately considered. The way to do that, we argue, is to design new altering rules that account for these intra-corporate impacts.

Our proposed solution, returned to in Part IV, is the introduction of a new class of altering rules: compound altering rules. These rules would allow shareholders to contract around certain governance provisions, such as director liability, on the condition that an additional governance instrument—such as a bylaw amendment or a minority shareholder vote—authorizes the contract. Not all default rules should require this level of authorization. For example, agreements between shareholders regarding voting rights typically do not necessitate input from non-party insiders. On the other end of the spectrum, for more significant changes, particularly those affecting fundamental shareholder rights, stricter requirements such as unanimity or class-specific votes may be necessary. Our point, however, is that there is a broad middle ground in corporate governance—situations like the example above—that should be governed by compound altering rules, ensuring that the interests of all stakeholders are adequately protected. The detail lies in precisely how to obtain that non-party consent.

III. First Principles of Corporate Altering Rules

The vast majority of rules that contemporary corporate law provides for corporations are default rules that corporations can freely alter. In that general sense, corporations enjoy "contractual freedom" to define both the basics and details of their governance. Yet *how* corporations change those rules—how they exercise their contractual freedom—is fundamentally distinct from how ordinary contractual parties exercise their contractual freedom outside of corporate governance. To begin with, corporations seldom rely on the rules that contracting parties almost always rely on, namely, making decisions unanimously among the parties. Instead, corporations rely on a wide variety of decision-making procedures to displace default rules of law and opt into rules of their own crafting. These rules provide different recipes for the exercise of corporate contractual freedom. A general theory of corporate contractual freedom, therefore, must explain what is distinctive about corporate contracting, the nature of corporate altering rules, and the factors that shape how courts and parties should select among possible altering rules for displacing the doctrines of corporate law.

A. Intra-Corporate Impacts

What distinguishes corporate altering rules from altering rules more generally? For us, the answer lies in the nature of corporate decision-making. Corporate decisions are generally not based on unanimity. This sharply distinguishes corporate decision-making from ordinary contractual decision-making; in the latter context, decisions to create and amend contracts are based on unanimity among all parties. Outside of the corporate context, restrictions on contractual freedom can usually be understood in two ways: paternalism and externalities.[57] The first set of constraints concern the impact of displacing the default on the contract parties themselves, that is, on persons internal to the contract (hence, they are sometimes called "internalities"). The second type of effect concerns the impact of displacing the default on non-parties, that is, on persons external to the contract (hence, reference to an "externalities" problem).[58]

Corporate law adds a third dimension: impacts on parties *outside* the decision-making process, yet still *inside* the corporation. For example, when two stockholders form a voting agreement, their contract impacts not just themselves (giving rise to paternalism concerns) or third parties outside of the corporation (giving rise to externality concerns), but also *other insiders to the corporation*. We refer to this last category as *intra-corporate impacts*.[59] The term encompasses all the ways in which the conduct of corporate insiders—owners and managers—affects other insiders. In principle, virtually any decision by the corporation or even individual shareholders affects the value of other shareholders' interests in the firm.[60]

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57 See, e.g., Ayres, supra note 8, at 2032.

58 To give an example of policies motivated by these two types of harms, consider the rationale for prohibiting credit agreements with "usurious" interest rates. One rationale for a mandatory rule against usurious interest rates is that it protects vulnerable or unsophisticated potential debtors. This is an internalities rationale because it concerns the impact of displacing the default on the contract parties themselves. For an externalities example, consider the mandatory antitrust rule against price fixing agreements. A price fixing arrangement presumably benefits the companies that fix prices, and is thus not ordinarily motivated by a desire to protect the contract parties. Instead, it is designed to protect consumers who would otherwise suffer higher prices on account of the price fixing. This is an externalities rationale because it concerns the impacts of displacing the default on consumers, who are non-parties or "external" to the contract.

59 To give two simple examples: a majority of board members can displace a default that binds all stockholders by amending the bylaws; a majority of stockholders can similarly bind all stockholders by amending the bylaws. There are countless others. *See ___ infra*.

60 For a similar concept in the context of debt markets, see Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 Nw. U. L. Rev. 565, 596-97 (1995) (discussing infra-firm externalities).

Corporate law does not require corporations to diverge from contract law's unanimity requirement, nor is unanimity completely foreign to corporate governance, as private companies are sometimes governed in part by voting agreements to which all shareholders and the board are parties. Yet a process by which every shareholder's consent is required for every action would be neither desirable, nor practicable. The result is that parties are affected by decisions made by others. In the standard contractual model, there is no such intermediate type of person. One is either a party to the contract (and thus consenting) or not a party (and thus not consenting).

Intra-corporate impacts emerge because, unlike in the standard contractual setting, those who *decide* whether to displace a default rule of corporate law are generally not the same as those who are *affected* by the new rule. Intra-corporate impacts create a unique set of problems that corporate altering rules must address. Courts should design altering rules to manage the intra-corporate effects of displacing the default. The failure to appreciate the basic conceptual building blocks of a corporate altering rule and to understand the functional consequences of design choices constitute the key conceptual hurdle to a coherent theory and jurisprudence of corporate law altering rules.

B. The Essential Features

Corporate law, and organizational law more generally, affords multiple mechanisms for collective decision-making. If the firm is a small partnership with three partners who are all actively involved in the business, then the owner-managers can conceivably follow a unanimous process for making all consequential decisions, including when to alter governing rules of law. The larger and more complex the business, however, the more firms tend to empower different decision-makers by different mechanisms to alter the governing rules. These rules have all kinds of features, too many too fully enumerate, such as notice and quorum requirements or restrictions on which kinds of instruments (such as a charter or operating agreement) can effect which kinds of alterations.

Yet, in our view, there are only two fundamental dimensions to every collective altering rule: The first dimension involves *whose approval* is required for a decision to be made. We call this feature *process*; it answers the question of "Who decides?" The second dimension involves who, as a formal matter, is *bound* by the decision. We call this feature *scope*; it answers the question of "Whose legal rights and duties are affected by the decision?" These two groups are always defined, whether explicitly or implicitly, by the altering rule. Ideally, every corporate altering law rule would (1) clearly define these two features and (2) select these two features to optimally address the intra-corporate impacts of displacing the default rule.

It is easy to see why these two features, which play such a critical role in corporate life, would not have been previously articulated or systematically analyzed by courts or commentators. The reason is that, *outside of the corporate context*, these two features are fixed and obvious. In contract, and outside of the corporate context, those who decide and those who are bound are one and the same. The rule is unanimity. All parties to the contract must consent, and all parties are bound.[61] There is no other altering rule in contract law. [62] The possibility that two parties could "agree" to bind a third party is antithetical to the concept of a contract, the hallmark of which is, famously, a mutual manifestation of assent of all parties involved.

In corporate law, and in great contrast to contract law generally, there are many altering rules that do not require assent of all parties involved; indeed, the corporate law norm is anti-unanimity. For example, sometimes, a majority of the board of directors can alter the default,[63] or a majority of shareholders,[64] or either one,[65] or only both together,[66] or a subcommittee of directors,[67] or a supermajority of shareholders,[68] or only all of them,[69] or only a minority of them.[70] Quorum requirements add another layer of variation on all these rules. In principle, a corporate law altering rule could specify any subset of corporate insiders as those who decide, and any other subset as those who are bound.

Notice there are two important components to specifying who decides: (1) the class of decision-makers (such as stockholders or directors) and (2) the decision rule (such as unanimity or majority rule). The class of persons are the set of actors who are empowered to decide. The decision rule is the percentage

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61 The idea that contracts bind those who given their consent is shared by lawyers and laypersons alike. See Roseanna Sommers, *Commonsense Consent*, 129 no. 8 YALE L.J. 2232, 2262-64 (2020).

62 To give a simple example, consider the default warranty of merchantability. Suppose Amy agrees to sell a car to Ben. If Amy and Ben do not alter the default, then the default warranty of merchantability applies. The only way for it to not apply would be for both Allee and Biff to mutually agree to alter it. To do this, they could include the language "as is" in their written agreement. Thus, the answer to "Who decides?" is "Allee and Biff." All contract parties decide by unanimity. What about "Who is bound?" That answer is equally obvious. Only Allee and Biff are bound. For example, suppose another buyer, Cary, comes along to buy a different car from Allee. Allee and Biff's agreement to alter the default warranty would not apply to the sale between Allee and Cary. Instead, Allee and Cary must decide all over again whether to displace the default warranty.

63Through a bylaw amendment, but that first requires that in the corporation's certificate of incorporation it conferred "the power to adopt, amend or repeal bylaws upon the directors." Del. Code Ann. tit.t 8, § 109(a).

64 Del. Code Ann. tit. 8, § 109(a).

65 *Id.*

66 Del. Code Ann. tit. 8, § 242(b).

67 Del. Code Ann. tit. 8, § 141(c).

68 Charters can adopt supermajority rules, *see* Del. Code Ann. tit. 8, § 216.

69 Shareholders cannot ratify corporate waste without a unanimous vote. *Lewis v. Vogelstein*, 699 A.2d 327, 335 (Del. Ch. 1997) ("it has long been held that shareholders may not ratify a waste except by a unanimous vote"). *See also*, *Saxe v. Brady*, 184 A.2d 602, 605 (Del. Ch.1962) ("Approval by a mere majority of stockholders does not ratify waste.").

70 As an example of such a voting block requirement, though not in the context of an altering rule, during Mark Zuckerberg's attempted recapitalization of Facebook's non-voting shares, he needed to amend the charter. This required the action to pass a majority vote of the minority shareholders, which he ultimately failed. A similar logic applies to the question of who is bound by such altering rules. The default standard by which a court will review an interested transaction between a director and the corporation is "entire fairness." It can be altered for a specific director if the other (disinterested) directors approve the transaction ex ante. Such approval, however, naturally applies only to the one director (and not to other directors or other transactions).

or threshold of those actors whose individual consent is required. As illustrations, consider amending the corporate charter versus a stockholders agreement. To amend the charter, two classes of persons must consent: the board and the stockholders. If a separate class vote is required for the charter amendment, then the number of classes will increase. For each of those classes, the decision rule will be a majority vote. Contrast that with a stockholder agreement. Only one class of persons is required to amend a typical stockholders agreement (the stockholders) and the decision rule is unanimity. Thus, a complete answer "Who decides?" requires one to specify both attributes, the class of decision-makers and the decision rule.

C. Secondary Features

We have characterized contract law as essentially having only *one* altering rule: unanimity. More precisely, contract law's answers to (1) "Who decides" and (2) "Who is bound" are (1) all parties decide and (2) all parties are bound. We offered this characterization in contradistinction to corporate law, which does not have the same, fixed answers to these questions. There are, of course, many nuances to contract law's altering rules. Contract law's altering rules are rich and varied and include things like special language and evidentiary requirements.[71] For example, contract parties can displace the default warranty of merchantability by using the expression "as is" or "with all faults."[72] But at a higher level of abstraction, in terms of essential features, there is only one altering rule for displacing defaults: unanimous consent, which binds all contractual parties.

Corporate law also has plenty of nuances. Some scholars have highlighted, for example, the importance of notice or disclosure requirements.[73] In corporate law, a distinction is often made between altering a default at the time corporation is formed ("initial" changes) and altering the default for existing corporation ("midstream" changes). The altering rule for staggering the board of directors is one such example.[74] But in our view, and again at a root conceptual level, these are not essential features. What makes process and scope essential is that they are the root causes of intra-corporate impacts, which in turn constitute the rationale—unique to the corporate context—for limiting contractual freedom.

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71 Limitations on liquidated damages can be interpreted as ex post evidentiary requirements for altering the default of expectation damages. *See, e.g.*, *In re Cellphone Termination Fee Cases*, 193 Cal. App. 4th 298, 322 (1st Dist. 2011) (providing that liquidated damages in consumer contracts are enforceable if the seller shows that "(1) fixing the amount of actual damages must be impracticable or extremely difficult and (2) the amount selected must represent a reasonable endeavor to estimate fair compensation for the loss sustained").

72 *See* UCC 2-316 (on disclaiming the implied warranty of merchantability).

73 See, *e.g.*, Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 Calif. L. Rev. 373 (2018)

74 The default board structure calls for a single class of directors, with each director up for election each year. A corporation can stagger the board by changing the number of classes to two or three. If three, then a third of the directors are up for election each year. There are both initial and midstream altering rules for this. Both initial and midstream staggering can be accomplished in either the charter or bylaws. But only midstream staggering requires a vote of the stockholders. Del. Code Ann. tit. 8, § 141(d).

These essential features also apply not just to stockholder contracts, but to *all* methods of displacing a default in corporate law. As we explain below, contracts are just one of four related governance instruments. (The others are the corporate charter, the bylaws, and board resolutions.) Process and scope are features of all four instruments. They serve as the conceptual foundation that unifies full extent of corporate law's sprawling landscape of altering rules, and characterize the basic bargaining environment by which a corporation's members decide whether to contract around a rule.

IV. Designing Corporate Altering Rules

In this Part, we identify some of the major considerations involved in designing altering rules and apply the first principles outlined in Part II.

A. Functional Considerations in Choosing among Process and Scope

Choosing a process and scope allows a court or parties to specify the basic attributes of an altering rule. As any practitioner can observe, the costs of choosing one process rather than another can be significant. The most efficient process will economize on firm decision-making so as to maximize the value of the firm. This means selecting a process and scope that will enable effective decision-making while minimizing the costs of opportunism. Because these types of costs are familiar, we only briefly discuss them.

Who Should Decide? A successful altering rule enables parties to opt out of the default rule of law when it is efficient to do so, but constrains opportunistic opt out. The most direct way to constrain opportunism is to identify the corporate constituency that is the most likely victim of an opportunistic opt out and grant it a veto right over the change to governance. This is probably the feature of altering rule design that is most systematically reflected in the DGCL itself.

This is obviously true of the requirement that both the board and shareholders approve a charter amendment, once a corporation has sold stock, but it is also present in the class voting requirement. Section 242(b)(2) of the DGCL grants the holders of a class of stock a mandatory, separate class vote if a charter amendment would change the powers or rights of the shares of that class "so as to affect them adversely."[75]

Decision Rules. In practice, the choice of decision rule is usually between majority or unanimity (with rarer instances of some supermajority rule). There are other rules, of course, including the default of plurality voting for elections of directors.

[75] DGCL 242(b)(2).

Section 7.32 of the Model Business Corporation Act renders a wide variety of stockholder agreements enforceable, but requires that the agreement be approved by all persons who are shareholders when the agreement is entered.

The major cost of unanimity is opportunism by minority interests, rather than the majority, in the form of *hold-up*. Parties whose consent is required may opportunistically threaten to prevent value-maximizing transactions unless they obtain a disproportionately large share of surplus. Presumably, it was the desire to reduce the economic costs of holdout that led corporation statutes to eventually dispense with unanimity requirements for mergers and to replace them with a majority vote.

Transaction costs of negotiation. The larger a company, the costlier it may become to involve a large number of classes in negotiating over whether and how to contract around a default. As a result, while it may be practicable and desirable to hold stockholder and board votes for a wide variety of issues in private companies, the same thing may not be true of public companies.

In short, there are costs that are predictably mitigated and generated by choosing one decision rule, say unanimity, rather than another, and similarly for choosing one or several classes of persons whose consent is required. While the balance of these costs will sometimes be obvious to casual observation, there will be often be difficult tradeoffs that only firms and practitioners will be in an effective position to balance. In other words, the purposes of identifying the principal factors relevant to firms' calculus is not to provide decisive guidance as to the right altering rule for each situation. Rather, it is help us ask the right questions and to understand the factors that are implicit or explicit in the choices courts and firms make regarding altering rule design.

Perhaps the most direct way to meet this challenge is to identify the corporate constituency that would be the likely victim of an opportunistic opt out and grant it a veto right over the change to governance.[76] The allocation of veto rights to constituencies will only succeed, however, where those constituencies are well-suited to effectively exercise their veto. This means that the parties holding the veto—given the information available to them, their skills, and their incentives—will generally exercise their veto right when it is in their interests to do so.

B. Publicly Ordered Altering Rules

1. *Three Types of Intra-Corporate Impacts*

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Corporate law's altering rules create three kinds of intra-corporate impacts, which we define as the impacts that fall on three groups (Table 1). These three groups are determined by the essential features of an altering rule. Because the altering rule determines who decides and who is bound, a corporate law altering rule could, in principle, produce up to four groups of corporate insiders: (1) those who both decided to displace the rule and who are bound by the displacement, (2) those who did not decide but are bound, (3) those who did decide but are not bound, and (4) those who did not decide and are not bound. (By "insiders," we mean to include at a minimum: directors, officers, controlling stockholders, and the corporate entity itself.)

Notice that, outside the context of a corporation, a contract law altering rule will produce only groups (1) and (4). That is, it will produce a group of persons who both decided to displace the default and are bound by the new rule (group 1, or the parties to the contract), and a group of persons who did not decide and are not bound (group 4, or everyone outside the contract). For this reason, we say that an altering rule is more "contract-like" to the extent it produces only groups (1) and (4). In the extreme case, a corporate law altering rule that prescribes a unanimity requirement and binds all insiders is, in its essential features, a contract law altering rule. The only difference is that in contract, the impacts on group (4) are a "pure" externality because they fall on third-party outsiders, while in the corporate context, group (4) can also include other insiders to the corporation (and thus generate an "intra-corporate" impact).

What about groups (2) and (3), the off-diagonal elements of Table 1? To us, it is less obvious how to characterize altering rules that tend to produce these groups. However, we think it may be appropriate to label them as more "property-like." This is because, at least within our system, property law's altering rules will tend to produce these groups. In property law, altering rules are traditionally rare, as much of the regime is mandatory.[77] But for the altering rules that do exist, the answer to "who decides?" is, in general, "the property holder(s)," while the answer to "who is bound?" is, in general, "everyone else."[78] In this way, there is no overlap between the two groups implicitly defined by the altering rule. To use one famous formulation, property rights are "good against the world,"[79] and so their altering rules will tend to produce off-diagonal groups: group (2), consisting of those who decided but are not bound (the property holder) and group (3), consisting of those who did not decide but are bound ("the world").

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77 Thomas W. Merrill & Henry E. Smith, *Making Coasean Property More Coasean*, 54 J. L. & ECON. S77 (2011).

78 For example, by default most states permit gun owners to carry concealed weapons onto private property. However, if a property owner posts signs forbidding others to carry guns onto their property, they can effectively alter the rules for their property and all potential visitors are bound. *See* Ian Ayres and Spurthi Jonnalagadda, *Guests with Guns: Public Support for "No Carry" Defaults on Private Land*, 48 S2 J. L. MED. & ETHICS 183, 184 (2020).

79 Thomas W. Merrill & Henry E. Smith, *What Happened To Property In Law And Economics*, 111 YALE L.J. 357, 358 (2001).

To see how corporate law's altering rules produce all four groups, consider the case of displacing the well-known default rule that directors are personally monetarily liable for breach of the duty of care. This rule can be displaced by charter amendment.[80] A charter amendment requires an affirmative vote of a majority of the board and a majority of shareholders. Once displaced, the new rule (eliminating personal liability) applies to all insiders: directors are not liable, and neither shareholders nor the corporation itself can recover monetary damages from a directory for breach of the duty of care.

Table 1: Altering rules create four groups of insiders

		Is the insider bound?	
		Yes	*No*
Did the insider decide?	*Yes*	(1) Internalties ("contract-like")	(2) Intra-corporate impact ("property-like")
	No	(3) Intra-corporate impact ("property-like")	(4) Intra-corporate impact ("contract-like")

Precisely how this rule maps to the four groups of insiders depends on the results of the vote. Suppose a corporation has 3 directors and 3 (equal) shareholders. Suppose further that 2 of the 3 directors approve, and that 2 of the 3 shareholders also approved. In this case, there are two groups of insiders. Using the numbering from the table, these are: group (1), which consists of the 2 directors and 2 shareholders who approved and are bound, and group (2), which consists of the 1 director, 1 shareholder, and (technically) the entity itself that did not approve but are still bound.

Though they did not emerge in this example, there are corporate law altering rules that could also create group (3) or group (4) types of insiders. For an example of (3), consider the default rule that directors may not appropriate a corporate opportunity without first presenting it to the board. The board can alter this rule for individual directors by passing a resolution waiving the corporate opportunities doctrine for that individual director.[81] Suppose a board does so for an individual director, Alice.[82] In this case, it is a majority of the board *excluding Alice* who decides, and it is only Alice (who did not decide) who is bound. The majority of the board excluding Alice would belong to group (3) because they displaced the default for someone else (Alice). At the same time, Alice would belong to group (2) because she did not decide but is bound.

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80 Del. Code Ann. tit. 8, § 102(b)(7)

81 Del. Code Ann. tit. 8, § 122(17)

82 *Id.*

For an example of (4), consider the default rule on voting. The default is that each shareholder may vote their shares (or not vote) in any way they choose. Shareholders can alter this by entering into voting agreements with each other. If two shareholders enter into such an agreement, then they both decide to displace the default and are bound. But this leaves other, non-party shareholders in group (4), who neither decided to displace the rule nor are bound—yet are still potentially impacted by the fact that other shareholders displaced the default for themselves.

One could apply this analysis—identifying types of intra-corporate impacts—for displacing any default rule in corporate law. The point here is that the displacement impacts insiders who were not part of the coalition that affirmatively decided to displace the default. Again, the key distinction is between the function of altering rules in the standard contractual setting versus the corporate setting. Altering rules in contract law produce only one group of insiders—those who decided and are bound. This is the group that potentially experiences internalities—which altering rules should be designed to mitigate (if those internalities are harmful). But altering rules in corporate law potentially produce up to four groups—only one of which experience internalities. When a default is displaced, the other three groups instead potentially experience "intra-corporate" impacts that conceptually lie between an internality and externality, depending on whether one takes the point of view of the decision-makers or the corporation as a whole. In theory, any displacement of a default—except one that requires unanimity among all insiders—can produce a group that experiences intra-corporate impacts. This is very much only a theoretical point, however; to the best of our knowledge, no altering rule in corporate law requires unanimity of all insiders.[83]

Corporate law altering rules should be designed to mitigate these intra-corporate effects (if they are negative) or encourage them (if they are positive).[84] In corporate law, the way that altering rules do this is by adjusting the two essential features: who decides and who is bound.

2. *Four Governance Instruments for Implementing Altering Rules*

Corporate law implements altering rules by forming or amending one of four types of *governance instruments*. Governance instruments are the sources of private ordering in business law, and include things like the partnership agreement, LLC operating agreement, and trust indenture.

In the case of the corporation, we identify four instruments: (1) the articles of incorporation (or "charter"), (2) the bylaws of the corporation, (3) resolutions passed by the board of directors, and (4)

[83] Some require unanimity among shareholders only. For example, the rule that the board cannot engage in an activity that constitutes "corporate waste" can be altered via unanimous shareholder vote. *See* fn 57.

[84] Holger Spamann highlights the latter in particular. He argues that business law should be designed so as to incentivize sophisticated insiders (such as controlling shareholders) and sophisticated outsiders (such as plaintiffs attorneys or investment bankers) to act in a way that creates value for unsophisticated or passive investors. *See* Holger Spamann, *Indirect investor protection: the investment ecosystem and its legal underpinnings*, 14.1 J. LEGAL ANALYSIS 17-79 (2022).

stockholder agreements. The first two (charter and bylaws) are sometimes collectively referred to as the "corporate documents." They are also the two that are traditionally identified as sources of private governance. In our view, however, these four instruments are variations on a single theme: Statutes and common law provide the default rules, and these four instruments are the means through which corporate insiders (directors, officers, stockholders, and the corporate entity itself) may displace the defaults. To the best of our knowledge, *every* altering rule in corporate law provides that exactly one governance instrument—a charter, bylaw, board resolution, or shareholder agreement—is enough to displace the default rule.[85] The four instruments provide the technologies for altering the rules of corporate law—and should thus be identified as forming a single conceptual and legal group. These are the four—and only four—where altering rules are applied.

The four instruments provide a complex mixture of process and scope, that is, they offer many responses to "who decides" and "who is bound" (Table 2). Bylaws, for instance, can typically be amended by a majority of the board *or* by a majority of shareholders.[86] Here, bylaws establish a procedural option: the answer to "who decides" is either a majority of the board or a majority of shareholders. To give another example, the charter may provide a supermajority requirement for amending certain provisions; this again would lead to at least two answers to "who decides," depending on the rule at issue.

Table 2:
Governance instruments distinguished by the essential features of their altering rules

Governance instrument	Feature 1: Who decides?	Feature 2: Who is bound?
Charter	Majority of board + majority of shareholders (by default)	Typically all, but also subsets or individuals
Bylaws	Majority of shareholders (by default; majority of board if so empowered in charter)[87]	Typically all, but also subsets or individuals
Board resolution	Majority of board (by default); a subset of board if so empowered by a majority of the board[88]	Typically all, but also subsets or individuals

[85] It is worth keeping in mind that courts have crafted a kind of compound altering rule by which parties can displace entire fairness as a standard of review in favor of business judgment review, when there is a conflicted transaction. The MFW framework requires the use of an independent board committee and a majority-of-minority shareholder vote to alter the standard of review.

[86] The former may be authorized by a charter provision. DEL. CODE ANN. tit 8, § 109.

[87] Del. Code Ann. tit. 8, § 109.

[88] Del. Code Ann. tit. 8, § 141(c).

Shareholder agreement	Unanimity (of parties to contract)	All parties to contract

As for scope, consider again the example of waiving the corporate opportunities doctrine for an individual director, Alice.[89] The board can do this by passing a resolution. In this case, a majority of the board decides (or a majority of the non-conflicted members), and the individual director Alice (who did not decide) is bound. There is no overlap between the coalition that decides and the coalition for whom the default is displaced. This is reminiscent of a property-like altering rule, which similarly has no overlap between who decides (the property holder) and who is bound (the rest of the world).

Similarly, a charter amendment can bind many different coalitions. Consider again the well-known default rule of DGCL 102(b)(7), which gives corporations power to adopt a charter amendment eliminating personal liability for directors or officers who breach of the fiduciary duty of care. In principle, a corporation could pass such an amendment but have it apply to directors only.[90] In this case, officers would have neither decided nor have had their default displaced. (Of course, they could still be economically affected by the elimination of directors' personal liability and not their own.) Using the numbering from table 1 (above), the officers would be in group (4). Alternatively, a corporation could adopt a 102(b)(7) provision that applied only to officers. In this case, officers would belong to group (3) because they did not decide but they are bound.

C. Privately Ordered Altering Rules

Altering rules can come from both public sources (the statute and common law) and private sources. As an illustration of the latter, here we briefly analzye the drag-along provision from the National Venture Capital Association's Model Voting Agreement. Drag-alongs are worth considering because they can exhibit considerable self-reflexivity about altering rule design and also because the terms of a drag-along were at the heart of both *Manti* and *Fugue*.

A drag-along right gives the holder of the right the ability to force signatories to participate in a sale of the company under predefined conditions; the signatories are, in effect, "dragged along." By agreeing to a drag-along provision, signatories concede their default right to freely sell or vote their shares when an offer is made for control of the company.[91] The NVCA drag-along also commits signatories to refrain from exercising any dissenters' rights, such as a right of appraisal in connection with the sale, or alleging

89 Del. Code Ann. tit. 8, § 122(17).

90 Indeed, many corporations have such a directors-only provision. This is because, until recently, 102(b)(7) only gave corporations power to eliminate or limit liability for directors (not officers).

91 To determine when an offer is made for the company, to choose not to sell their shares (in the event of an offer for stock) or to not vote their shares (in the event of a merger proposal).

any breach of fiduciary duty against the selling stockholders, directors, or acquirer in connection with the sale.

The basic logic of the drag-along provision is that, in the event that a given party or set of parties approve a sale of the company,[92] each signatory to the provision agrees to also vote all their shares in favor of the sale (if it requires stockholder approval), or, to sell their shares (if the sale is structured as a stock sale). The drag-along alters the default rule that every stockholder can individually decide ex post whether to vote or sell their shares in favor of a change of control. It contracts around the default and places those decision rights in others' hands.

The principal way in which a drag-along illustrates the fundamental features of an altering rule is that it demonstrates the enormous flexibility parties enjoy in designing process and the stakes of those choices. Whose approval is required to trigger the drag-along? The model provision provides a number of choices, including the holders of preferred stock, the holders of common stock, and the board, with the percentage of stockholders approving the sale varying from a majority upward. Contract provides indefinite flexibility as to which class of parties' consent is required to alter a default, and the decision rule chosen for each of those classes of parties. If you only require the consent of a majority of preferred stockholders, then you in effect give them a unilateral right to force the sale of the company. There is significant room for ex post opportunism, unless the parties carefully structure their other rights. On the other hand, if the drag-along requires the approval of 90% of the stockholders of each separate class of stock and the board, then it essentially only eliminates hold-outs.

Designing altering rules is difficult because the rule necessarily offers a single response that must solve for two different but related issues: the opportunism hazards that can be *mitigated* through granting a party a veto (reducing agency issues by the rights holders), and the opportunism hazards that are *created* by granting a party a veto (generating hold-up).

D. A New Approach: Compound Altering Rules

Having considered publicly and privately provided altering rules, we now apply our theory of altering rules to illuminate and expand the potential landscape of corporate law's rules. The set of corporate law's potential altering rules is much greater than courts and scholars have acknowledged. This is true even when viewed in the narrow terms of corporate law's essential features of process and scope. The extant rules combine a handful of approaches to process and scope, and then operationalize these approaches as the formation and amendment rules for four governance instruments (the charter, bylaws, board resolutions, and stockholder contracts).

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92 A sale of the company is defined as a transaction(s) in which a person acquires from company stockholders shares representing more than 50% of the voting power or there is a liquidation event, as defined in the charter.

One response to this observation—that corporate law's actual altering rules is a mere fraction of its potential altering rules—is that most of these potential rules are of little use. The statutes and common law, in their unyielding wisdom, have simply selected among the infinitude of potential rules the small handful that are of any practical utility. This is far from the case, and as a counterexample, in this section we propose a new class of altering rules, one that, in our view, presents itself as inevitable given our theory of altering rules. As explained above, every default rule in corporate law can be altered using exactly one of the four governance instruments. The new class of altering rules we propose would require two. For this reason, we refer to these as *compound altering rules*.[93]

Here we will restrict our attention to compound altering rules that combine (1) a stockholder contract with (2) either (a) a charter or (b) a bylaw amendment that requires a shareholder vote. Put another way, this kind of compound rule would enable stockholders to displace a default by contract provided there is a charter or bylaw provision authorizing such contracts.

This kind of altering rule presents several advantages to the current approach to enabling (or disabling) stockholder contracting. The current approach is to either allow stockholders to contract around a given rule, or to prohibit them from contracting around the rule. The problem with the first option (permitting contractual workarounds) is that it does not address the potential intra-corporate harms. The problem with the second approach (prohibiting workarounds) is that it shuts down potentially valuable avenues of innovation. We view compound rules as not so much a "compromise" between the two approaches, but rather as the only approach that adequately addresses both issues: promoting innovation while also addressing intra-corporate harms. A compound altering rule implicitly forces the contract parties to negotiate and potentially compromise with the group upon whom an intra-corporate impact might fall (the non-parties to the contract). For example, if paired with a bylaw amendment, then the altering rule would permit a contractual workaround provided the stockholders can persuade a majority of the non-party shareholders. More broadly, a compound rule would shift the locus of decision-making (over whether to permit certain kinds of agreements). Instead of courts or the legislature providing a one-size-fits-all rule, each individual corporation would, as a whole, decide whether to permit a certain contractual practice. Indeed, one could imagine a supermajority requirement in settings that are at greatest risk of abuse. For example, the compound rule could require a majority non-party stockholder vote to authorize the contract in private companies, and a supermajority (or unanimous) vote in public companies (where shareholders are generally less sophisticated). This would promote innovation while also checking opportunities for abuse.

We do not mean to suggest that a compound rule is some kind of silver bullet, or that all mandatory rules in corporate law should instead be defaults combined with a compound altering rule. This does

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93 To the best of our knowledge, there are no compound altering rules in corporate law. However, one quasi-exception is Del. Code Ann. tit. 8, § 109(a). By default, only shareholders can change the bylaws. Under Section 109, a corporation can adopt a charter provision authorizing the board to unilaterally change the bylaws. We call this a quasi-exception because this different processes for a bylaw amendment, but it is generally applicable to any bylaw amendment, not to a particular default rule of corporate law.

not follow from our theory. There may still be plenty of good arguments for prohibiting certain contracts based on paternalistic or negative externalities—and we do not claim otherwise. Our claim here is instead that compound altering rules are uniquely well designed to manage the intra-corporate impact of stockholder contracting. Loosely speaking, in the marginal case where corporate law prohibits a certain kind of contractual arrangement (such as agreeing not to sue for breach of fiduciary duty), a compound rule could outperform the relatively extreme policies of unconditional permission or outright prohibition. More generally, as we broaden the landscape of its altering rules, such as by introducing compound rules, the case for the contractibility of corporate law's fundamental rules becomes stronger.

One can find analogies to compound altering rules outside of corporate law, in contexts where displacing a given default produces complex impacts across jurisdictions, mirroring the complexities of intra-corporate impacts. Two examples come to mind. The first example is the National Popular Vote Interstate Compact, which is an agreement across states to award all electoral college votes to the winner of the national popular election rather than, as is typical, to the winner of that state's popular vote. This is an attempt to implement a compound altering rule that is implicit in the Constitution's provision granting states the power to appoint electors.[94] It is a compound rule because the Compact comes into effect only when states representing a majority of the electoral college adopt it—and thus requires amendments to multiple state laws (i.e., to multiple governance instruments).[95] Another example is the Miller-Tydings Act,[96] which lets states authorize the practice of "resale price maintenance." This also used two instruments to displace the Sherman Act, which would prohibit such practices. The two instruments are (1) a federal statute, the Miller-Tydings Act itself, which in turn authorizes (2) a state law, which would establish a local exception to the Sherman Act.[97]

V. Implications

In this final Part, we unpack the implications of our approach to altering rules, with specific application to the recent disputes involving stockholder contracts (Sections A and B). We also respond to potential objections to our approach to altering rules and stockholder contracting, which, compared to the current situation, is more expansive and flexible.

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94 *See* U.S. CONST. art. II, § 1, cl. 2.

95 Depending on one's interpretation, it may also require a federal law. See U.S. Const. art. I, § 10, cl. 3.

96 50 STAT. 693 (1937). The Act was later repealed in 1976 by the Consumer Goods Pricing Act. For a discussion of this legislation, *See* David W. Boyd, *From "Mom and Pop" to Wal-Mart: The Impact of the Consumer Goods Pricing Act of 1975 on the Retail Sector in the United States*, 31.1 J. OF ECON. ISSUES 223 (Mar. 1997).

97 To give an example outside the law, compound altering rules are like "two-person controls" in military contexts. The usual image is of a submarine missile system that requires two people, each independently in control of a key, to simultaneously turn each key in order to initiate a launch. Such controls are designed to prevent accidental or unauthorized use of high-stakes systems.

B. Stockholder Contracting

As we explained in Part I.C., the cases of *Manti*, *Fugue*, *Moelis*, along with the amendments to Section 122(18) that overturn *Moelis*, together constitute a major shift in Delaware's willingness to enable corporations and their shareholders to tailor the rules of corporate law by contract. These cases and proposed amendments reflect, sometimes explicitly though more often implicitly, a mix of approaches to corporate law altering rules.

The greatest contrast in approach comes from comparing *Fugue* with the amendments to Section 122(18). Both authorize certain types of contracts: *Fugue* authorized stockholder agreements that waive the right to sue for breach of the duty of loyalty; the proposed amendment would authorize a board to contract away its powers under 141(a), provided the same could be accomplished in a charter. Both took a rule that was until then mandatory (the duty of loyalty and 141(a), respectively) and turned it into a default.

Yet only *Fugue* took the altering rule seriously. Recall that *Fugue* held that a written agreement not to sue for breach of fiduciary duty is enforceable provided it (1) is "narrowly tailored" to a specific transaction and (2) passes a catch-all reasonableness test (for which the court provides a non-exclusive list of factors).[98] Nonetheless, although *Fugue* was not quite framed this way, one can interpret its logic as primarily an attempt to craft a thoughtful altering rule for tuning the duty of loyalty (at least in this narrow case) into a default rule. Condition (1) included a requirement that the contract itself specifically foreseeable; while condition (2) included a requirement that the stockholders be sophisticated and represented by counsel. The first would rule out a blanket waiver of the duty, while the second would practically rule out the possibility of binding certain types of parties (such as retail stockholders of a public company) by simply attaching the waiver to a share itself. Condition (1) sounds more in the vein of paternalism, while condition (2) seems more designed to permit waivers only when the participants in the bargaining process were sophisticated and bargaining itself was real.

Unlike the altering rule announced in *Fugue*, the amendments make no effort, explicitly or implicitly, to address the intra-corporate effects of a board ceding power to a controlling shareholder. Indeed, the amendments establish no guardrails at all to promote efficient or actual bargaining over the reallocation of corporate power. The opportunities for abuse are self-evident, especially in public companies with passive shareholders, as controllers can dominate the board and extract all kinds of rents. To be sure, there is the implicit constraint of directors' background fiduciary obligations. Yet is far from clear whether and how such obligations would apply here. In this way, the amendments introduce a new source of legal uncertainty over the boundary between fiduciary obligations and contractual freedom. It places a burden ex-post on courts to resolve that uncertainty. *Fugue*, by contrast, both offers a sensible

98 *Fugue*, 295 A.3d at 589-90.

altering rule that more prudently places the burden to negotiate the fiduciary-contract divide ex-ante on the contract parties themselves.

The point here is not that *Fugue* necessarily announced the optimal altering rule. Rather, the point is that *Fugue* at least made an effort, and sophisticated one at that, at addressing intra-corporate impacts of waiving a right so fundamental as the right to sue for breach of fiduciary duty. The proposed amendments, meanwhile, enabled corporations to displace DGCL 141(a)—the centerpiece of Delaware's corporate law statute—yet made no such effort to meaningfully address the intra-corporate harms of doing so.

Beyond that, we think revisiting *Fugue*, *Manti*, and other cases permitting waivers illustrates the utility of our approach. Many may already embrace the thoughtful altering rule designed by *Fugue*. *If*, however, one worries about the intra-corporate effects of individual shareholders waiving their statutory rights on other shareholders, *then* we believe that concern can be accommodated through altering rule design, rather than turning to a mandatory rule. In particular, we think a compound rule requiring shareholders to approve the permissibility of individual waivers would effectively accommodate most or all of the concerns motivating opponents of *Fugue*. Our most basic idea is that more creative use of altering rule design by courts and parties weakens the case for mandatory rules because appropriate altering rule design can accommodate many of the concerns, such as mitigating opportunism, that motivate proponents of mandatory rules.

C. What Should Courts Do?

When deciding whether a rule should be mandatory, courts should first clearly distinguish among the three types of impacts: (1) internalities, (2) externalities, and (3) intra-corporate impacts. In our view, category (3) does not receive enough attention. To see why, consider the standard contract setting. In this setting, the presence of an internality or externality is merely a necessary condition for making a rule mandatory—and thus limiting freedom of contract. That is, if displacing a given default creates (net) harms on the contract parties (internalities) or on non-parties (externalities), then there is a good case for making the rule mandatory. But to this we would add a proviso: the presence of (net negative) internalities or externalities is a good reason for making the rule mandatory—*provided that there is no altering rule that can adequately address those harms*.

Internalities are often easier to mitigate than externalities because they are limited to the contract parties themselves. For example, if the harm arises because one party is uniformed, then an information-forcing altering rule (or default rule) can work to inform the uninformed party.[99] Externalities, by contrast, are

[99] For example, courts take the default quantity to be zero when parties fail to specify. This penalty default forces the parties to include a quantity term in their contracts by punishing them for failing to do so. Ian Ayres & Robert Gertner, *Filling*

often more dispersed and thus harder to address through an altering rule. For an example here, consider covenants not to compete. Even if the employer and employee are both better off with one, they may still be socially wasteful because lower labor market competition raises prices for all consumers. Yet it is hard to come up with a feasible altering rule that would adequately address such harms. In a Coasean utopia of zero transaction costs and full information, an altering rule requiring the consent of all parties who could possibly be affected by the noncompete (including consumers impacted by higher equilibrium prices) would be suitable. But in the real world, such contractual approaches are infeasible, and a mandatory rule against noncompetes may be appropriate as a second-best.[100] Indeed, though the FTC did not phrase it this way in its final rule banning noncompetes, this is the altering-rule-centric argument that we, applying our theory, would have made if asked to justify the ban.

The same logic should apply in the corporate setting. But the key is to distinguish true externalities from mere intra-corporate impacts. Externalities may, as in contract, be a sufficient reason to make a corporate law rule non-contractible. It may be too difficult to get non-party consent or implement some other altering rule that adequately addresses the externality (as in the noncompete example). But the same is not true for intra-corporate harms. These harms fall on the insiders who did not decide but are either bound (as a legal matter) or negatively impacted (as an economic matter). In such cases, courts should first identify the intra-corporate effects and then articulate an altering rule that would address these impacts. If such a rule would be infeasible to implement, then there may be case for making a rule mandatory. But given the possibility of adopting a "pure" contract-like altering rule of *unanimous* consent, we think such cases would be rare. In the absence of a paternalistic or negative externalities rationale, it is hard to argue with unanimity. Thus, unlike negative externalities, the potential for intra-corporate harms is, by itself, not a good reason to make a corporate law rule mandatory.

More broadly, any plausible approach to opt out in corporate law must have far more to say about the role of the courts than we have had the space to develop here. It has been said that perhaps the core mandatory feature of corporate law is not a specific substantive doctrine, but the central role of the courts in reviewing corporate action.[101] Delaware's courts would retain a fundamental, if somewhat different role in a world where altering rules were more creatively and pervasively used.

Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 YALE L.J. 87, 98 (1990). *Also see* Ian Ayres, *Ya-Huh: There Are and Should Be Penalty Defaults*, 33 FLA. ST. U. L. REV. 589, 597 (2006).

100 Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. pt. 910 (2024), available at https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.

101 John C. Coffee Jr., T*he Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, (1989). Professor Coffee sketches a subtle position between the advocates and opponents of corporate mandatory rules that emphasizes the reach and limits of courts' competence to monitor opportunism, a set of standards by which courts should review opt out decisions, and substantive limits on the process of opt out (like transaction specificity). *Id*. at 1674-76, 1690-91. *See also* John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual theory of the Corporation, and the Special Case of Remedies*, 53 Brook. L. Rev. 919, 972-974 (1988) (advocating for quality-constrained private ordering that requires corporations opting out of traditional norms of corporate governance to prove that the amendment is not against public policy). Among the ways that Professor Coffee envisions a corporation satisfying the public policy requirement, subject to a set of additional standards, is to show they adopted a model provision drafted by a representative

Just to sketch some considerations, we envision courts playing an important common law policymaking role in designing altering rules, absent systematic legislative attention to the process. They would also play an important role in reviewing the adequacy of disclosures made in connection with alterations, in reviewing officers and directors' conduct in arranging the process, and in interpreting firms' privately ordered altering rules.

D. Objections and Qualifications to Our Approach

In this section, we respond to two important objections to our more flexible approach to corporate altering rules. A reader may wonder (1) whether this approach undermines Delaware's brand because it complicates the simplicity of Delaware corporate law, and (2) whether it is unnecessary because alternative entities, such as the limited liability company, already exist and have few or no mandatory rules. We address each in turn. We then turn to a number of questions raised by our approach.

1. *Delaware's Brand*

One potential objection is that Delaware's success flows from the simplicity and uniformity of the corporate governance of companies incorporated there. That uniformity allows investors to avoid having to read cumbersome and complicated charters and permits stable expectations as to what corporate law looks like, reflecting its mandatory rules. Although we think that Delaware does have a valuable brand, the simplicity and uniformity of Delaware corporate governance cannot explain it.

The idea that Delaware corporations have simple and uniform corporate governance is a mythology. Private companies incorporated in Delaware routinely have extremely varied, complex, and creative corporate governance. Venture capital-backed startups are typically incorporated in Delaware and represent an important source of dynamism and growth for the U.S. economy.[102] The leading provider of standard form terms for these startups, the National Venture Capital Association, supplies model legal documents that are widely adopted.[103] The model charter runs to 48 pages.[104] It creates multiple classes and series of stocks and grants distinct and lengthy lists of powers and privileges to each. The

group. Under our understanding of this argument, this would allow for substantial tailoring of otherwise mandatory norms, although not the "anything goes" private ordering that Easterbrook and Fischel arguably sought. For instance, the opt outs in *Manti* and *Fugue* would presumably qualify, given that they are based on the widely adopted model forms of the NVCA. *Id*. at 974 ("Informed shoppers look at the label, and so might informed courts.").

102 Josh Lerner & Ramana Nanda, *Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn*, 34 J. Econ. Persp. 237, 253 (2020).

103 NVCA, *Model Legal Documents*, https://nvca.org/model-legal-documents/.

104 Id.

model voting agreements runs to 16 pages.[105] Empirical research on the provisions that late-stage startups adopt suggests that simplicity is, in fact, the exception.[106] Complexity and creativity is the rule, not the exception.

It is not just private corporations either. Delaware public corporations can and do tailor their governance. They can go public subject to complicated shareholder agreements.[107] The multi-class structures of Google and the voting trusts of Facebook are well-known. Beyond high-tech giants, though, even Visa has a 48-page charter.[108] The country's most dynamic and valuable companies exhibit considerable governance complexity. Providing new avenues for arriving at optimal governance is unlikely to move the dial materially on this dimension. Sophisticated investors already need to read corporate charters to understand the governance of Delaware corporations.

Thus, far from being adverse, our approach is consistent with Delaware's brand. Delaware corporate law has never been static. Its history involves repeated revision to its statute and an evolving common law jurisprudence.[109] The constant, if anything, has been an incremental responsiveness and adaptiveness to changing business, legal, and economic circumstances.[110] Indeed, the current trend—decades in the making—has been to eschew substantive second-guessing of managers' decisions in favor of promoting *processes* through which high-quality decisions are reached.

2. *Alternative Entities*

The second objection is that our approach is largely unnecessary because those who want greater contractual freedoms can select from several alternative business entities. The United States affords many popular alternatives to the partnership and the corporation, such as the limited liability company and limited partnership. These statutes focus on providing maximal contractual flexibility. The Delaware LLC statute announces that "[i]t is the policy of this [Act] to give the maximum effect to the principle of freedom of contract."[111] Given this, a reader may reasonably wonder why increasing

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105 Id.

106 Dhruv Aggarwal et al., *The Rise of Dual-Class Stock IPOs*, 144 J. Fin. Econ. 122, 127 (2022) (providing evidence of complexity of startup charters pre-IPO).

107 Rauterberg, *supra* note __.

108 Amended and Restated Certificate of Incorporation of Visa, Inc., Ex. 3-1, https://www.sec.gov/Archives/edgar/data/1403161/000119312507212797/dex31.htm.

109 Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 Del. J. Corp. L. 885, 900-01 (1990); Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 Colum. L. Rev. 1749, 1755 (2006); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 Cardozo L. Rev. 709, 709 (1987).

110 Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. Cin. L. Rev. 1061, 1063 (2000); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 Vand. L. Rev. 1573, 1619-22 (2005).

111 Del. Code Ann. tit. 8, § 18-1101(b) (2018). On LLCs use of this freedom, see Peter Molk, *Protecting LLC Owners While Preserving LLC Flexibility*, 51 U. Cal. Davis L. Rev. 2129, 2190 (2018).

contractibility in the corporation is necessary, and whether it collapses the distinction between the corporation and these alternative entities.

But even if every entity form permitted a firm to contract around a default, the entities would remain fundamentally distinct because they differ over *how* they permit alterations.[112] What distinguishes entities is not just what they permit, but *how* they permit it. Even if there were no mandatory rules, entities would still fundamentally differ because they offer different altering rules—and we do *not* argue in favor of permitting corporations to alter defaults in the same way as the LLC. On the contrary, we do not think a charter should be able to waive the fiduciary duty of loyalty for all shareholders, in the way an LLC operating agreement can for all LLC members. (At most, we might allow more careful and prespecified opt-outs, perhaps with a compound rule with *Fugue*-like safeguards.) Our argument is that corporate law needs to appreciate the greater number of altering rules available to it, so that courts can develop and make use of this flexibility in permitting firms to waive defaults.

Our vision of corporate law's contractual freedom is not one that is unfettered by rules, so that shareholders can do whatever they please. Rather, our vision of corporate contractual freedom is one that is carefully managed through the common law development of appropriate altering rules that enable firms to tailor the fundamentals of their governance.

E. Conclusion

Corporate law is at a crossroads. Delaware's courts are increasingly being asked to enforce or invalidate shareholder contracts that challenge the foundational principles of corporate governance. These cases ask the courts to effectively choose between corporate law's traditional pillars and corporate contractual freedom. How can they do this in a way that both promotes the innovation in governance while protecting against potential abuse?

In this article, we offered our response. At bottom, our claim is that courts should dedicate less effort to debating the merits or demerits of freedom of contract or the "foundational" status of a given rule of corporate law—and much more effort developing corporate law's *altering rules*—the procedures by which corporations and corporate actors displace the default rules of corporate law.

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112 Vice-Chancellor Laster supplies a compelling version of this argument. New Enter. Associates 14, L.P. v. Rich, 295 A.3d 520, 530 (Del. Ch. 2023) ("Another rhetorically powerful argument asserts that permitting a stockholder to covenant not to sue for breach of the duty of loyalty will collapse the distinction between a corporation and an LLC. That is not so, as the fundamental differences between corporations and LLCs operate at the basal level of their statutes and constitutive documents. There is a superficial similarity between the ability of investors in corporations and LLCs to contract about their investor-level rights, but that resemblance does not turn corporations into LLCs.").

The bulk of this article laid out our theory of corporate law's altering rules. We identified an altering rule's *process* (who decides to displace the default) and its *scope* (who is bound by the decision) as its essential features, the foundation from which any analysis of corporate law's altering rules should begin. Having laid out the theory, we argued that corporate law's landscape of potential altering rules is much richer and powerful than appreciated. As one example, we suggested a compound altering rule, which is specifically designed to manage intra-corporate impacts of stockholder contracting. This rule allows for contractual alterations, contingent upon authorization from another governance instrument—be it the charter, bylaws, or a board resolution. Such a rule would alleviate much of the intra-corporate harms and tension that implicitly underlie some of the more contentious recent cases. Yet this is only one example. Courts should develop them to expand the contractual frontier of corporate governance.