FREEDOM AND ITS LIMITS
IN THE DELAWARE GENERAL CORPORATION LAW

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ABSTRACT

This article examines the concept of "freedom of contract" in Delaware corporation law. We first summarize some of the important enabling provisions of the Delaware General Corporation Law (DGCL) that give stockholders broad freedom to set the terms that will govern their corporation, and also identify three mandatory provisions that appear to limit that freedom. We then examine the competing arguments scholars have offered for and against freedom of contract in corporation law. We argue that most of the scholars' arguments are outdated because they fail to account for the availability of other forms of business entity that permit even greater freedom of contract—in particular, Delaware limited partnerships and limited liability companies. Finally, we suggest an alternative explanation for the limited set of mandatory terms in the DGCL: specifically, that the existence of mandatory terms guaranteeing certain core qualities benefits all Delaware corporations by saving the expense investors would otherwise incur to investigate whether a particular corporation had or lacked those core qualities.

I. INTRODUCTION

Unlike the Delaware Revised Uniform Limited Partnership Act (DRULPA) and the Delaware Limited Liability Company Act (LLC Act), the Delaware General Corporation Law (DGCL) has never included an express statement of legislative policy to give "maximum effect to the principle of freedom of contract." Consequently, in Sterling v. Mayflower Hotel Corp., the Delaware Supreme Court held that the stockholders of a Delaware corporation had broad power to include provisions in the certificate of incorporation departing from the rules of the common law and

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1See DEL. CODE ANN. tit. 6, § 17-1101(c) (2008); id. § 18-1101(b).
293 A.2d 107 (Del. 1952).
many sections of the DGCL.\textsuperscript{3} Indeed, Professor Folk noted almost forty years ago that "the Delaware corporation enjoys the broadest grant of power in the English-speaking world to establish the most appropriate internal organization and structure for the enterprise."\textsuperscript{4}

But even this broad freedom has limits. The Delaware courts have held that certain aspects of the corporation law are mandatory and that provisions of a certificate of incorporation that try to deviate from them are void. For decades, legal scholars have debated whether and why any mandatory terms should exist in corporation law. A 1989 symposium published in the Columbia Law Review presented some of the best academic thinking on the subject at the time. In that symposium, "contractarian" scholars argued against mandatory terms,\textsuperscript{5} while others argued in favor of certain mandatory terms.\textsuperscript{6}

In this article, we examine the concept of "freedom of contract" in Delaware corporation law. In Part II, we summarize some of the important enabling provisions of the DGCL that give stockholders wide latitude to set the terms that will govern their corporation. In Part III, we identify three significant remaining mandatory provisions that stockholders may not contract around: the stockholders' right to elect directors; the stockholders' right to inspect books and records for a proper purpose; and the directors' duty of loyalty. In Part IV, we examine the justifications scholars have offered for applying a "freedom of contract" principle to corporation law, as well as the justifications offered for mandatory terms limiting that freedom. In Part V, we argue that the scholars' arguments (on both sides of the debate) are outdated in that they fail to account for the ready availability of other forms of business entities that permit even greater freedom of contract than that available under the DGCL—in particular, Delaware limited liability companies and limited partnerships. Instead, we suggest an alternative justification for the limited set of mandatory terms that exist in the DGCL.\textsuperscript{7} Specifically, mandatory terms

\textsuperscript{3}Id. at 117-18.

\textsuperscript{4}ERNEST L. FOLK, III, AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW 5 (1969).


\textsuperscript{7}We do not adopt or advocate a view in this article with respect to potential amendments to the DGCL.
guarantee that certain core qualities are associated with the particular "brand" of business entity called a "Delaware corporation." The existence of that brand benefits all Delaware corporations by saving the expense investors would otherwise incur to investigate whether a particular entity had or lacked any of those core qualities. At the same time, parties who wish to deviate from the mandatory terms in the corporation law can easily do so by choosing a different "brand" and forming a limited liability company or limited partnership.

II. FREEDOM OF CONTRACT IN THE DGCL

The DGCL gives incorporators enormous freedom to adopt the terms they believe are most appropriate for the organization, finance, and governance of their particular enterprise. Most of the rules set forth in the DGCL are expressly subject to terms of the certificate of incorporation that "otherwise provide." Indeed, the Delaware courts have held that even where a provision of the DGCL does not expressly provide that it is subject to a contrary provision in the certificate of incorporation, that may still be the case. As a result, much of the DGCL creates statutory rules that are merely "defaults." They apply only so long as the parties to the corporation choose not to deviate from them. Accordingly, "Delaware's corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations . . . ."

A large body of scholarship has explained that an important purpose of contract law should be to provide efficient default rules that provide terms that parties would adopt ex ante if they took the time to bargain about them, while

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8See 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, 973-74 (1988) (analogizing corporation statutes to brands and recommending the development of "more quality brands" rather than permitting contracting out of mandatory terms).

9Id.

10The "Delaware Model" is "largely enabling and provides a wide realm for private ordering." Leo E. Strine, Jr., Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1260 (2001). Delaware is the leader, but not alone in this respect, as almost every state corporation statute is enabling. See Easterbrook & Fischel, supra note 5, at 1417.


12Jones Apparel, 883 A.2d at 845.
permitting parties to strike a different bargain if they wish. From there, it is a small step for scholars to describe corporations as a "nexus of contracts" and apply the same reasoning to corporation statutes. On this view, corporation statutes should supply efficient default rules that minimize transaction costs, while permitting parties to bargain for different rules if they wish.

Scholars' desire to apply contract law principles to corporation law is not surprising. Delaware courts have long described the certificate of incorporation as a contract among the stockholders, to be interpreted in accordance with contract law principles. And the Delaware corporation statute has long embodied a structure of default rules that stockholders can bargain around by including contrary provisions in their certificate of incorporation.

The DGCL gives stockholders broad discretion to establish at the outset whatever terms for the organization, management, and finance of the corporation they believe will best serve the needs of the particular enterprise. Section 102(b)(1) of the DGCL provides that a certificate of incorporation may contain "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders . . . if such provisions are not contrary to the laws of this State." The Delaware Supreme Court has held that section 102(b)(1) "confers, in the

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16Morris v. Am. Pub. Utils. Co., 122 A. 696, 700 (Del. Ch. 1923) ("That a corporate charter is a contract has been long settled."); See also Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114, 120 (Del. 2006) ("It is settled law that certificates of incorporation are contracts . . . ."); In re Bicoastal Corp., 600 A.2d 343, 350 (Del. 1991) ("A certificate of incorporation is viewed as a contract among shareholders . . . ."); Waggoner v. Laster, 581 A.2d 1127, 1134 (Del. 1990) ("A certificate of incorporation is viewed as a contract among shareholders . . . ."); In re Explorer Pipeline Co., 781 A.2d 705, 713 (Del. Ch. 2001) ("Certificates of incorporation are not only contracts among a corporation and its shareholders, but also are contracts among the shareholders."); Gaskill v. Gladys Belle Oil Co., 146 A. 337, 339 (Del. Ch. 1929) ("It is elementary that the rights of stockholders are contract rights.").
17Benihana of Tokyo, 906 A.2d at 120; In re Bicoastal Corp., 600 A.2d at 349; Berlin v. Emerald Partners, 552 A.2d 482, 488 (Del. 1989).
most general language, the right to include in a certificate of incorporation any provision deemed appropriate for the conduct of the corporate affairs. 19

Section 102(b)(1) bars only provisions "contrary to the laws" of Delaware. That bar has been narrowly construed. It does not preclude a certificate provision that varies a rule of common law. 20 As the court explained in Sterling:

The rapid development of corporation law in this country—certainly in this state—furnishes repeated examples of departure from common law principles, and negatives the suggestion that the legislature intended by [the predecessor of section 102(b)(1)] to codify (in effect) all the common law rules applicable to the governance of corporate affairs. 21

It also does not preclude a certificate provision altering default rules found in the various sections of the DGCL, even if those sections do not expressly authorize variance by a certificate of incorporation. 22 The Delaware

19 Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 117 (Del. 1952). See also Frankel v. Donovan, 120 A.2d 311, 316 (Del. Ch. 1956) ("Charter provisions which facilitate corporate action and to which a stockholder assents by becoming a stockholder are normally upheld . . . unless they contravene a principle implicit in statutory or settled decisional law governing corporate management.").

20 Sterling, 93 A.2d at 117-19 (upholding certificate provision permitting interested directors to be counted toward quorum despite common law decisions precluding same); see also Butler v. New Keystone Copper Co., 93 A. 380, 382 (Del. Ch. 1915) (upholding certificate provision authorizing sale of all assets by a three-quarters stockholder vote, rejecting argument that such a provision was not authorized by statute and that, absent statutory authorization, the common law rule of unanimous stockholder approval governed). But see State ex rel. Cochran v. Penn-Beaver Oil Co., 143 A. 257, 259 (Del. 1926) (en banc) (invalidating certificate provision denying stockholder inspection right; reasoning of case questioned by Sterling, 93 A.2d at 118).

21 Sterling, 93 A.2d at 117-18.

22 See Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 847-48 (Del. Ch. 2004) (upholding certificate provision altering default rule in section 213 because the provision was not contrary to Delaware law, but noting that not every statutory grant of authority may be altered by a certificate provision; rather, a court must determine, based on a careful context specific review, whether a particular certificate provision contravenes Delaware public policy in the form of statutory or common law). For other cases dealing with the scope of the general permission clause, see also Providence & Worcester Co. v. Baker, 378 A.2d 121, 124 (Del. 1977) (upholding certificate provisions restricting stockholders' voting rights and establishing quorum requirement for stockholder meetings); Seibert v. Gulton Indus., Inc., No. 5631, 1979 Del. Ch. LEXIS 469, at *7-10 (Del. Ch. June 21, 1979), reprinted in 5 DEL. J. CORP. L. 514, 517-18 (1980) (upholding certificate provision for shifting voting requirements relating to mergers), aff'd, 414 A.2d 822 (Del. 1980); Frankel, 120 A.2d at 316-17 (interpreting certificate provision involving stock options); Martin Found., Inc. v. N. Am. Rayon Corp., 68 A.2d 313, 316 (Del. Ch. 1949) (upholding certificate provision defining the directorial interest that would be disqualifying).
Court of Chancery pointed out in Jones Apparel Group, Inc. v. Maxwell Shoe Co. that for section 102(b)(1) to have meaning, it must not be limited to altering default provisions in statutory sections that contained "magic words" permitting contrary provisions—"[i]f [section] 102(b)(1) may be utilized only when the specific statute granting the board authority contains the magic words, then there is no independent utility to [section] 102(b)(1)."

Instead, the Delaware Supreme Court held in Sterling that section 102(b)(1) bars only certificate of incorporation provisions that would "achieve a result forbidden by settled rules of public policy." Hence, "the stockholders of a Delaware corporation may by contract embody in the [certificate] a provision departing from the rules of the common law, provided that it does not transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself." Vice Chancellor Wolcott noted in an early corporate case that "[n]o individual may exercise his broad power to enter into contract relations with another so as to offend against what the law deems to be sound public policy."

More recently, in Jones Apparel, the Delaware Court of Chancery applied the Sterling doctrine in holding that a provision in a certificate of incorporation limiting the record date for any stockholder action by written consent was not invalid even though it eliminated the discretion of the board of directors to set such a record date as contemplated by section 213. The defendant corporation argued that the relevant provision of its certificate of incorporation was invalid because section 213 did not state that the board's discretion was subject to contrary provisions in the certificate of incorporation. The court rejected the argument, finding no settled public policy forbidding the removal of that discretion from the board.

Section 141(a) offers an additional source of freedom to adopt non-standard governance rules. It establishes the default standard that the business and affairs of the corporation are to be managed by a board of directors, but expressly permits the certificate of incorporation to provide otherwise.

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23 Jones Apparel, 883 A.2d at 848.
24 Sterling, 93 A.2d at 118. See also Aldridge v. Franco Wyo. Oil Co., 14 A.2d 380, 381 (Del. 1940) (striking down power conferred by certificate on a class of shares because it was not within the "express words or necessary intendment" of the corporation law and, by implication, it was inconsistent with "the public policy of the State with respect to corporate control").
25 Sterling, 93 A.2d at 118. The court conceded that "the limits of 'public policy' are ill-defined and changing." Id.
27 Jones Apparel, 883 A.2d at 848-49.
28 Id. at 844.
29 Id. at 847.
Additionally, section 141(a) states that a certificate of incorporation may provide that the powers and duties otherwise conferred or imposed on the board by the DGCL shall be exercised or performed by others. The fact that a Delaware corporation need not have a board of directors is also recognized in section 142(e), which provides for vacant corporate offices to be filled "by the board of directors or other governing body."

Even before the 1967 revision of the DGCL, section 141(a) contained a proviso authorizing deviations from the default standard of board management. Thus, in 1966 the Delaware Supreme Court held in Lehrman v. Cohen that directors had not impermissibly delegated their statutory duties to the corporation's general counsel because the general counsel's right to resolve board deadlocks was set forth in the certificate of incorporation. The court explained:

It is settled, of course, as a general principle, that directors may not delegate their duty to manage the corporate enterprise. But there is no conflict with that principle where, as here, the delegation of duty, if any, is made not by the directors but by stockholder action under [section] 141(a), via the certificate of incorporation.

Professor Folk noted the breadth of this ruling in the first edition of our treatise:

Although the procedure upheld in Lehrman was bolstered by the fact that public policy does not bar devices to break deadlocks, it seems clear that the decision does not turn solely on that factor, but instead recognizes the power of stockholders to establish any type of internal corporate structure they desire so long as it does not violate some other statutory provision or public policy. At the very least, there is nothing in the Delaware statute to require rigid adherence to the traditional corporate norm, and every reason to conclude that the statute and case law tolerate, if not

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31 id.
32 id. § 142(e).
33 222 A.2d 800, 807-08 (Del. 1966).
34 id. at 808 (citation omitted).
actually encourage, deviations from the corporate norm which have a "proper purpose."\textsuperscript{35}

Even if incorporators choose not to deviate from the default structure of a board of directors, section 141(d) gives them broad flexibility to establish a board consisting of different classes of directors with different terms, rights, and powers.\textsuperscript{36} Thus, stockholders could agree, in the certificate of incorporation, upon a structure that gives certain directors more votes than others, or that permits certain directors to vote on particular matters while other directors may not.\textsuperscript{37} Moreover, section 142 leaves to the bylaws and the board of directors the power to designate corporate officers with whatever titles and duties may be desired, and for such terms as may be prescribed by the bylaws or board.\textsuperscript{38}

The DGCL also permits the broad discretion to establish, in the certificate of incorporation, the terms that will govern the finance of the corporation as well as the economic and voting rights of the stockholders. For instance, section 151(a) authorizes a corporation to have different classes of stock (and different series of stock within any class) with such rights, powers, and preferences as may be set forth in the certificate of incorporation (or resolved by the board if the certificate of incorporation gives the board that power).\textsuperscript{39} Other subsections of section 151 specifically permit the certificate of incorporation to provide for special treatment of particular classes of stock with respect to dividends, dissolution, redemption, and conversion.\textsuperscript{40} As a result, the DGCL "provides great flexibility to shareholders in creating the capital structure of their firm."\textsuperscript{41} Thus, stock can be created with voting rights but no economic rights, or with economic rights but no voting rights.\textsuperscript{42} Indeed, as long ago as 1944, the Delaware Supreme Court noted that "a certificate of

\textsuperscript{35}ERNEST L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW 54 (1972).
\textsuperscript{36}\"[T]he certificate of incorporation may confer upon 1 or more directors, whether or not elected separately by the holders of any class or series of stock, voting powers greater than or less than those of other directors.\" DEI. CODE ANN. tit. 8, § 141(d) (2001).
\textsuperscript{37}Id. § 142(a).
\textsuperscript{38}Section 142 requires the corporation to have such officers as are required to sign instruments to be filed with the Secretary of State and stock certificates. Id. Section 103(a)(2), however, permits a filing with the Secretary of State to be made by any authorized officer. Id. § 103(a)(2). Also, section 158 permits a board of directors to resolve that the corporation's shares will be uncertificated. Id. § 158. Thus, effectively, the DGCL requires only that the corporation have at least one officer authorized to act for it, but imposes no requirements as to the title or duties of that officer.
\textsuperscript{39}Id. § 151(a).
\textsuperscript{40}DEI. CODE ANN. tit. 8, § 151(b)-(e) (2001).
\textsuperscript{42}Lehrman v. Cohen, 222 A.2d 800, 807 (Del. 1966).
incorporation may contain any provision with respect to the stock to be issued by the corporation, and the voting rights to be exercised by [the] stock, that is agreed upon by the stockholders, provided that the provision agreed to is not against public policy.\(^{43}\)

Section 212 adds additional flexibility, authorizing the certificate of incorporation to provide more or less than one vote per share on any matter.\(^{44}\) As a result, voting power may vary not only between classes, but within a class as well. In *Providence & Worcester Co. v. Baker*, the Delaware Supreme Court held valid a provision entitling each stockholder to one vote for every share of common stock the stockholder owned not exceeding fifty shares and one vote for every twenty shares more than fifty the stockholder owned.\(^{45}\) In so holding, the court stated, "Under [section] 212(a), voting rights of stockholders may be varied from the 'one share-one vote' standard by the certificate of incorporation . . . ."\(^{46}\) The Delaware Court of Chancery has also upheld provisions requiring stockholder approval measured on a per capita rather than per share basis,\(^{47}\) a provision allowing different voting rights based on the duration of stockholding,\(^{48}\) and a provision altering the vote that would otherwise have been necessary for stockholder approval of a transaction.\(^{49}\)

These broadly enabling statutory provisions are the product of a long-term trend toward greater freedom in the establishment of the governing terms for a corporation.\(^{50}\) Indeed, the notion that corporation statutes should be "enabling"—that is, should enable incorporators freely to establish corporations with a wide variety of governing terms—is hardly new.\(^{51}\) Professor Folk noted in 1968 that "[t]he long-run trend has been to remove restrictions from

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\(^{44}\) *DEL. CODE ANN. tit. 8, § 212* (2001).

\(^{45}\) 378 A.2d 121, 122-24 (Del. 1977).

\(^{46}\) *Id. at 123.*


the corporation law"52 and, in the first edition of our treatise, noted that for decades Delaware had been the "pace-setter" for American corporation statutes.53

This trend did not end with the 1967 revision of the DGCL. Perhaps the most significant post-1967 amendment was the adoption in 1986 of section 102(b)(7).54 Section 102(b)(7) authorizes a corporation to include in its certificate of incorporation a provision limiting or eliminating the personal monetary liability of directors for breach of the fiduciary duty of care.55 Section 102(b)(7) was added because insurance for directors' liability had become more expensive and sometimes unavailable, and a concern developed with respect to the ability of corporations to continue to attract and retain qualified directors. In addition, the insurance crisis threatened desirable entrepreneurial decision making. In response to this problem, the Delaware General Assembly decided that Delaware corporations should be authorized to include provisions in their certificates of incorporation limiting or eliminating the personal liabilities of directors for breach of the fiduciary duty of care.56

52 Ernest L. Folk, III, Recent Developments in Corporation Statutes, 20 J. LEGAL EDUC. 511, 516 (1968).
53 Folk, supra note 35.
56 The legislative synopsis and commentary regarding the 1986 amendment adding section 102(b)(7) provide in their entirety as follows:

SYNOPSIS

Section 102(b)(7) and the amendments to Section 145 represent a legislative response to recent changes in the market for directors' liability insurance. Such insurance has become a relatively standard condition of employment for directors. Recent changes in that market, including the unavailability of the traditional policies (and, in many cases, the unavailability of any type of policy from the traditional insurance carriers) have threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions. The amendments are intended to allow Delaware corporations to provide substitute protection, in various forms, to their directors and to limit director liability under certain circumstances.

Commentary on Section 102(b)(7)

This provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminate or limit personal liability of members of its board of directors or governing body for violations of a director's fiduciary duty of care. However, the amendment makes clear that no such provision shall eliminate or limit the liability of a director for breaching his duty of loyalty, failing to act in good faith, engaging in intentional misconduct or knowingly violating a law, paying a dividend or approving a stock repurchase which was illegal under 8 Del. C. § 174, or obtaining an improper personal benefit. This provision would have no effect on the
Section 102(b)(7) is not the only post-1967 amendment offering greater flexibility with respect to issues of fiduciary duty. Section 122(17) was added to the DGCL in 2000, and permits a corporation to:

[r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders.\(^5\)

III. THE LIMITS OF FREEDOM

Although broadly enabling, the DGCL does have some mandatory rules governing the powers, rights, and duties of investors and managers.\(^5\) It may be that the mandatory rules that exist today will be loosened tomorrow. Professor Folk noted that a "natural working out of the historical evolution of availability of equitable remedies, such as an injunction or rescission, for breach of fiduciary duty.

S. 533, 133d Gen. Assembly (Del. 1986); 65 Del. Laws, c. 289, §§ 1-2 (1986). The Delaware Supreme Court has noted that section 102(b)(7) was adopted in 1986 following a directors and officers insurance liability crisis and the 1985 Delaware Supreme Court decision in Smith v. Van Gorkom, and the purpose of the section was to permit stockholders to adopt a certificate of incorporation provision to free directors of personal liability in damages for due care violations, but not duty of loyalty violations, bad faith claims, or for certain other conduct. Once the statute was adopted, the court noted, stockholders usually approved certificate amendments containing these provisions because such provisions freed up directors to take business risks without worrying about negligence lawsuits. Malpiede v. Townsend, 780 A.2d 1075, 1095 (Del. 2001) (en banc) (referring to Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)); see also Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) (noting that "[t]he purpose of section 102(b)(7) was to permit shareholders—who are entitled to rely upon directors to discharge their fiduciary duties at all times—to adopt a provision in the certificate of incorporation to exculpate directors from any personal liability for payment of monetary damages for breaches of their duty of care, but not for disloyalty violations, good faith violations and certain other conduct. Following [its enactment], the shareholders of many Delaware corporations approved . . . [such provisions] with full knowledge of their import."); Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 793 (Del. Ch. 2004) (noting that the purpose of section 102(b)(7) was to encourage "capable persons to serve as directors . . . by providing them with the freedom to make risky, good faith business decisions without fear of personal liability").


\(^5\)Of course, the DGCL also contains other mandatory provisions relating to various procedural issues and for the protection of third parties, such as requirements for public filings, the payment of taxes, and the existence of a registered agent to accept service of process. See, e.g., id. § 103 (regulating filings with the Secretary of State); id. § 126 (denying banking power); id. §§ 131-132 (requiring registered office and registered agent). We do not attempt to address such provisions in this article.
corporation statutes" was "to remove restrictions from the corporation law."\textsuperscript{59} "Even today," he wrote forty years ago, "we smile indulgently, chuckle at some remnant of regulation surviving in an unamended statute . . . ."\textsuperscript{60} At least for now, however, provisions in a certificate of incorporation that purport to deviate from the remaining mandatory rules are invalid and void.\textsuperscript{61}

Various scholars have compiled lists of aspects of Delaware corporation law they believe are mandatory.\textsuperscript{62} Some of these terms are not really mandatory because the same effect can be achieved through a different method. For instance, some have suggested that section 141(c)(2)’s requirement that matters submitted to stockholders for approval be approved by the full board rather than a committee is mandatory.\textsuperscript{63} If it is, this requirement can still be bargained around by virtue of section 141(d), which permits the creation of classes of directors with different voting powers. In other words, the certificate of incorporation could provide that only a certain class of directors has the power to vote on matters submitted to stockholders for approval. Indeed, the very existence of the board of directors, which has sometimes been identified as a mandatory feature of the Delaware corporation, can be modified by provision in the certificate of incorporation adopted under section 141(a), as noted above.\textsuperscript{64}

To be sure, not every provision of the DGCL has yet been measured against the test established in \textit{Sterling}. But three significant mandatory concepts emerge from the case law: the stockholders' right to elect directors; the right of a stockholder to inspect corporate books and records for a proper purpose; and the directors' duty of loyalty.

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\textsuperscript{59}\textit{Folk, supra} note 52, at 516.
\textsuperscript{60}\textit{Id.}\textsuperscript{61} Additionally, the national stock exchanges impose requirements on listed companies that are often more stringent than the DGCL. Those requirements are not truly mandatory, however, in that a corporation can avoid them by simply choosing not to be listed.
\textsuperscript{62}\textit{Eisenberg, supra} note 6, at 1481-82; \textit{Gordon, supra} note 6, at 1553 n.16.
\textsuperscript{63}\textit{See Easterbrook & Fischel, supra} note 5, at 1417; \textit{Eisenberg, supra} note 6, at 1482 n.98; \textit{Gordon, supra} note 6, at 1553 n.16.
\textsuperscript{64}In addition to the leeway permitted by section 141(a) to place the board of directors' powers and duties elsewhere, section 107 permits the incorporators to manage the business and affairs of the corporation until directors are elected. \textit{Del. Code Ann. tit. 8, § 107} (2001). The Delaware Court of Chancery has noted that "[t]he extent to which an incorporator can refuse to name a board of directors until the first annual meeting . . . has [not] been decided." \textit{Grant v. Mitchell, No. 18,370, 2001 Del. Ch. LEXIS 23, at *24 n.17} (Del. Ch. Feb. 23, 2001).
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A. Election of Directors

Section 211(b) requires a corporation to hold an annual meeting of stockholders for the election of directors unless directors are validly elected by written consent.\footnote{Del. Code Ann. tit. 8, § 211(b) (2001).} Section 211(c) gives teeth to this requirement by authorizing the Delaware Court of Chancery to summarily order a meeting to be held if one has not been held within thirteen months of the last annual meeting or action by written consent electing directors (although the Delaware Court of Chancery's power to order a stockholders' meeting pursuant to section 211 is discretionary).\footnote{Clabault v. Caribbean Select, Inc., 805 A.2d 913, 918 (Del. Ch. 2002), aff'd, 846 A.2d 237 (Del. 2003); see also Del. Code Ann. tit. 8, § 211(c) (2001).} Section 141(d) permits a certificate of incorporation (or an initial bylaw or a bylaw adopted by the stockholders) to provide for a classified or "staggered" board, with each director serving a three-year term.\footnote{Del. Code Ann. tit. 8, § 141(d) (2001).} It is commonly thought that the maximum term for directors on even a classified board is three years,\footnote{E.g., Eisenberg, supra note 6, at 1481; Gordon, supra note 6, at 1553 n.16.} but an expansive reading of the 1974 amendment to section 141(d) might permit longer terms.\footnote{It might be argued that section 141(d) authorizes provisions in a certificate of incorporation creating directorships with terms longer than three years. Specifically, following the amendments adopted in 1974, section 141(d) provides in part that: [t]he certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation. The terms of office and voting powers of the directors elected [separately by the holders of any class or series of stock] may be greater than or less than those of any other director or class of directors. Del. Code Ann. tit. 8, § 141(d) (2001) (emphasis added). However, the stockholders of the class electing such directors would retain the right of removal pursuant to section 141(k). In Rohe v. Reliance Training Network, Inc., No. 17,992, 2000 Del. Ch. LEXIS 108 (Del. Ch. July 21, 2000), reprinted in 27 Del. J. Corp. L. 410 (2000), the Delaware Court of Chancery held that this right of removal was "a fundamental element of stockholder authority" and "could not be impaired by either the certificate or the bylaws." Id. at *37, *39, reprinted in 27 Del. J. Corp. L. at 429.}

The Delaware Court of Chancery has suggested that the right of stockholders to periodically elect the board of directors is fundamental and that a certificate of incorporation may not provide permanent tenure. Thus, in \textit{Rohe v. Reliance Training Network, Inc.}, the Delaware Court of Chancery noted that, "except in the case of a properly classified board, all directors must [face] the electorate on [an] annual basis at the corporation's annual . . . meeting,"\footnote{Rohe, 2000 Del. Ch. LEXIS 108, at *36-37, reprinted in 27 Del. J. Corp. L. at 428; see also Roven v. Cotter, 547 A.2d 603, 605 (Del. Ch. 1988) ("The stockholders elect directors for a
annual meeting for the election of directors "regardless of whether . . . its Certificate of Incorporation was originally intended to provide a permanent tenure for the seven identified directors."  

B. Inspection Rights

Section 220 provides that a stockholder shall have the right to inspect corporate books and records for any proper purpose.\textsuperscript{72} The Delaware Court of Chancery has held that a stockholder's rights under section 220 cannot be limited by a provision in a corporation's certificate of incorporation or bylaws.\textsuperscript{73} For instance, in Loew's Theatres, Inc. v. Commercial Credit Co.,\textsuperscript{74} the Delaware Court of Chancery held that a provision in the certificate of incorporation limiting the right to inspect the corporation's books and records to only those stockholders who held twenty-five percent of the corporation's stock was void because it violated section 220.\textsuperscript{75} In Jones Apparel, the Delaware Court of Chancery offered dictum explaining the importance of inspection rights:

Plainly, the right of stockholders to inspect books and records is one that is necessary to allow stockholders—the owners of Delaware corporations—to monitor their fiduciaries' discharge of management duties. Section 220 therefore codifies the important public policy that "any" stockholder must be permitted to obtain corporate information so long as she can demonstrate "any proper purpose," and a charter provision that divests all but the most significant stockholders of that right is one that is contrary to the laws of this State as expressed through the policy reflected in [section] 220 and the decisional law emphasizing the fundamental importance of that right.\textsuperscript{76}

\textsuperscript{71}Rohe, 2000 Del. Ch. LEXIS 108, at *37, reprinted in 27 DEL. J. CORP. L. at 428.
\textsuperscript{72}DELAWARE COD. ANN. tit. 8, § 220 (2001).
\textsuperscript{73}Marmon v. Arbinet-Thenxchange, Inc., No. 20,092, 2004 Del. Ch. LEXIS 44, at *17 n.12 (Del. Ch. Apr. 28, 2004) ("If any such charter provision limiting disclosure exists in this case, it is void to the extent that it abridges or limits shareholder inspection rights under [section] 220."); see also Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc., 535 A.2d 1357, 1359 (Del. 1987) ("[T]he right of a stockholder to inspect and examine the books and records of a corporation . . . can only be taken away by statutory enactment.").
\textsuperscript{74}43 A.2d 78 (Del. Ch. 1968).
\textsuperscript{75}Id. at 81.
\textsuperscript{76}Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 849 n.30 (Del. Ch. 2004)
Scholars have concluded that the stockholders' right under section 220 to inspect books and records for a proper purpose is mandatory.77

C. Duty of Loyalty

No section of the DGCL provides that directors owe fiduciary duties. Rather, fiduciary duties have been established by the common law. The clear, negative implication of section 102(b)(7) is that a provision in a certificate of incorporation that purported to exculpate directors for breaches of the duty of loyalty would be invalid and unenforceable.78 As a result, scholars consider the directors' duty of loyalty to be a mandatory feature of Delaware corporation law.79

Nevertheless, at least three provisions in the DGCL permit corporations to provide some measure of protection to directors for approving transactions that might otherwise be seen as a breach of the duty of loyalty. First, section 122(17) permits the corporation to renounce, in advance, categories of corporate opportunities, thereby freeing directors to take for themselves opportunities that might otherwise have belonged to the corporation.80 Second, section 144 permits the corporation to engage in transactions with interested directors so long as they are approved by a majority of the stockholders or by a majority of the interested directors.81

(emphasis omitted).

77 See Gordon, supra note 6, at 1554 n.16.
79 Eisenberg, supra note 6, at 1481; Gordon, supra note 6, at 1554 n.16.
80 DEL. CODE ANN. tit. 8, § 122(17) (2008). As Chief Justice Steele noted in a 2007 article: The Delaware General Assembly recognizes the value of bargaining for limitations on traditional fiduciary duty principles . . . . Corporate opportunity 'takings' were, until [the adoption of section 122(17)], a fundamental focus in the development of the constraints imposed by the common law on fiduciaries under the heading of the duty of loyalty.
81 DEL. CODE ANN. tit 8, § 144 (2001). Judicial interpretations of section 144 have been inconsistent. In its earliest decision construing section 144, the Delaware Supreme Court rejected the argument that section 144 was intended to provide a broad immunity for judicial scrutiny. The court held that compliance with section 144 "provides against invalidation of an agreement 'solely' because" of a conflict of interest, but "[n]othing in the statute sanctions unfairness . . . or removes the transaction from judicial scrutiny." Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976). Eleven years later, in Marciano v. Nakash, the court seemed to take a different view, suggesting
Third, section 145(g) permits a corporation to purchase and maintain insurance against liabilities incurred by directors even in circumstances where the corporation would be prohibited from indemnifying the director directly.82

IV. JUSTIFICATIONS

A. The Case for Freedom of Contract in Corporation Law

The argument for freedom of contract in certificates of incorporation is by now commonly understood (if not necessarily commonly accepted). Different firms in different circumstances will be best served by different governing rules—i.e., one size does not fit all.83 The persons most likely to know what governing rules will best serve their particular firm and maximize the parties' aggregate wealth are the parties themselves, not legislators or courts.84 Yet, mandatory rules prohibit at least some parties from crafting the terms that best meet their specific needs.85 Stated differently, people are better off with more rather than with fewer options, and mandatory rules limit options.86

The same argument applies even where the certificate of incorporation is not the product of actual negotiation among the initial stockholders, but instead is a "contract of adhesion" drafted by incorporators who then seek to sell stock in an initial offering to potential investors who are free to purchase, or not, as they see fit. Potential investors will recognize that the terms of the

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82DELAWARE CODE ANN. tit. 8, § 145(g) (2001).
83See Easterbrook & Fischel, supra note 5, at 1418 ("No one set of terms will be best for all; hence the 'enabling' structure of corporate law.").
84Larry E. Ribstein, The Mandatory Nature of the All Code, 61 GEO. WASH. L. REV. 984, 996-97 (1993). See also Easterbrook & Fischel, supra note 5, at 1418. As they explain: The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy. No one set of terms will be best for all; hence the "enabling" structure of corporate law.
85Macey, supra note 15, at 189.
86Gordon, supra note 6, at 1553.
certificate of incorporation may affect the value of their investment, and the market will generate a price for the initial offering that reflects the value of those terms. That market, it is argued, can be relied upon to incentivize incorporators to draft terms that maximize the aggregate wealth of the incorporators and stockholders together. 87

A charter term that significantly affected risk or return should be noticed by the informed investor, in the same way that any other business factor would be noticed. ... [U]nder a regime of contractual freedom it would be astonishing if, for example, a firm junked annual election of directors in favor of a self-perpetuating board without affecting the issuance price of the next common stock offering. In other words, if mandatory provisions were eliminated, then presumably the charter would be subject to much closer scrutiny and we would readily observe price effects for significant variations from the standard form. 88

Thus, "contractarians" argue that permitting parties to agree upon the terms that will govern their relationship is justified on the ground that they will all be better off than if a single option is forced upon them. 89 Elimination of the existing mandatory terms would simply cause certificates of incorporation to receive closer scrutiny from potential investors, who would protect themselves by paying less for securities that involved more risk (or simply not buying them at all). In turn, incorporators would only deviate from standard terms where they believed that the gains from nonstandard terms outweighed the loss from the lower price paid by investors. Thus, deviation from standard terms would only occur where it would increase the aggregate welfare of incorporators and investors.

B. The Case for Mandatory Rules

In opposition, "anti-contractarian" scholars have offered several justifications for mandatory rules in corporation law: paternalism, efficiency of judicial interpretation, and the risk of opportunistic amendments.

87 Easterbrook & Fischel, supra note 5, at 1420, 1430-31; Macey, supra note 15, at 187-89.
88 Gordon, supra note 6, at 1562.
89 Id. at 1553. See also Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 NW. U. L. REV. 913, 944 (1982) ("The purpose of corporation law is to provide a set of organizing principles under which private parties can enter into contractual arrangements that maximize their joint welfare.").
One justification frequently offered for mandatory rules is paternalism. On this theory, investors cannot be expected to understand the full implications of particular provisions in a certificate of incorporation and should therefore, for their own protection, be forbidden from agreeing to them. Responding to the market theory set out above, some scholars argue that potential investors in an initial offering cannot be expected to study certificates of incorporation or adequately gauge the risk of future opportunistic behavior by management and therefore may be misled into buying stock despite unfavorable terms. Surely, for instance, no informed and rational investor would invest funds with a manager who owed no duty of loyalty; yet, without a mandatory rule, some investors might be misled into doing just that. Mandatory terms are therefore necessary to protect investors who are unable to adequately protect themselves.

Another justification offered is that mandatory rules create benefits for third parties—specifically, other corporations and the taxpayers who support the judicial system—and those benefits would be lost if the mandatory rules were eliminated. For instance, it has been argued that all Delaware corporations benefit from the existence of an established and continually growing body of case law addressing governance disputes arising under the provisions of the DGCL. Every corporation that opts out of a standard default term reduces the value of Delaware law to other corporations because judicial precedents applying the standard terms will be fewer, and judicial precedents applying nonstandard terms will be less valuable.

Moreover, as the argument goes, the expanded use of novel and idiosyncratic terms would impose costs on the public in the form of a greater load on the judicial system to resolve disputes involving issues of first

\[90\text{See Clark, supra note 15, at 1718-26.}\]
\[91\text{See Eisenberg, supra note 6, at 1465-66 (discussing the need, based on evidence showing that individuals tend to underestimate risks, for mandatory rules to allow courts to override bargains in order to prevent opportunism).}\]
\[92\text{Lucian Arye Bebchuk, Foreword, The Debate on Contractual Freedom in Corporate Law, 89 COLUM. L. REV. 1395, 1406 (1989); Eisenberg, supra note 6, at 1516-24 (examining the limits of the argument that corporations that are about to go public should be permitted to vary core fiduciary or structural rules). As Professor Eisenberg argued:}\]
\[\text{[E]xploitation of a variation in a core fiduciary or structural rule might or might not occur, and if it did occur, would normally occur in the future. Given the difficulty of estimating the probabilities, and the need to discount any future loss by the time value of money, the effort required to price a variation often might not be justified}\]

\[\text{Id. at 1517.}\]
\[93\text{See Eisenberg, supra note 6, at 1511.}\]
\[94\text{Gordon, supra note 6, at 1567-69 (discussing the costs imposed on all firms as a result of those with customized charters).}\]
impression. On the other hand, each of the three mandatory rules identified above—stockholders' election of directors, inspection rights, and the duty of loyalty—are frequent topics of litigation in Delaware. Permitting stockholders to contract out of them might well reduce the load on the judicial system. In fact, the principal reason scholars have advanced to explain why investors might rationally agree to waive these protections is to avoid the imposition of litigation costs on their firm.

Finally, many of the objections to greater freedom of contract in corporation law arise from the fear that after the firm is up and running and investors have committed their capital, management will pursue amendments to the certificate of incorporation that effectively transfer wealth from stockholders to management. But these concerns about "midstream opting out" could be addressed fully by enforcing certain provisions only if they were present in the original certificate of incorporation or an amendment approved unanimously. The LLC Act contains such provisions. In other words, it might seem unfair to permit fifty-one percent of stockholders to amend the certificate of incorporation to eliminate all stockholders' inspection rights; but the unfairness is harder to detect if stockholders adopt such an amendment unanimously. As Professor Jonathan Macey explains:

[I]f mid-stream corporate changes are deemed to be a problem, the solution is not to forbid enabling rules by making corporate law mandatory. Rather, the solution is to improve the mechanism for promulgating enabling rules by allowing the

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95 Coffee, Jr., supra note 6, at 1678.
96 See Ribstein, supra note 84, at 1021 (observing that mandatory rules encourage litigation).
98 Macey, supra note 15, at 192 ("If new enabling rules either cannot be changed or can only be changed with great difficulty, then the problem of mid-stream corporate changes diminishes or goes away."). See also Henry N. Butler & Larry E. Ribstein, Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians, 65 WASH. L. REV. 1, 65 (1990) (arguing for opt out provisions based on unanimous agreement of the stockholders).
99 For instance, section 18-305(g) of the LLC Act provides that the inspection rights of a member or manager may be restricted "in an original limited liability company agreement or in any subsequent amendment approved or adopted by all of the members." DEL. CODE ANN. tit. 6, § 18-305(g) (2005).
100 See Bebchuk, supra note 92, at 1399 ("The questions of contractual freedom in the initial charter and in midstream (that is, after the corporation has been formed and its initial charter set) are different and require separate examination.").
contracting parties to make credible commitments that mid-stream corporate changes will not occur.101

V. CONCLUSION

Most of these academic explanations suffer from a common defect: the failure to account for the availability of other business forms that permit even greater freedom of contract than permitted by the DGCL.102 As noted at the outset, both the LLC Act and the DRULPA contain express statements that the legislative policy of the statute is "to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company [or limited partnership] agreements."103 The Delaware courts have largely recognized and applied that policy.104

Indeed, each of the mandatory terms of the DGCL identified above is absent from the LLC Act and the DRULPA. The fiduciary duty of loyalty is not mandatory. Rather, parties forming a Delaware limited liability company or a Delaware limited partnership are specifically authorized by statute to agree that the managers or general partners will not owe any fiduciary duty of loyalty to the members or limited partners.105 The rights of investors to inspect books and records is not mandatory. Rather, the LLC Act and the DRULPA specifically authorize provisions restricting inspection rights.106 The right of investors periodically to elect managers is not mandatory. Rather, parties forming a limited liability company (LLC) or limited partnership may agree to permanent or self-perpetuating managers and general partners.107

Those who oppose mandatory terms in the DGCL must explain why their proposed DGCL would not be redundant in light of the existing LLC Act and DRULPA. What would be the point of permitting greater freedom of contract under the DGCL when it already exists under the LLC Act? Surely it

101Macey, supra note 15, at 193.
102But see Mark J. Loewenstein, A New Direction for State Corporate Codes, 68 U. COLO. L. REV. 453, 470-73 (1997) (advocating a dual system of Colorado business entity law in which the corporation statute retains many traditional mandatory features while a consolidated non-corporate business entity statute would be entirely enabling); Ribstein, supra note 84, at 1019 (predicting that adoption of the ALI Code, which included many mandatory provisions, would result in a drastic reduction in use of the corporate form).
103DEL. CODE ANN. tit. 6, § 18-1101(b) (2005); id. § 17-1101(c).
104Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291-92 (Del. 1999) (dismissing derivative suit based on arbitration clause in parties' limited liability company agreement). But see generally Steele, supra note 80.
105See DEL. CODE ANN. tit. 6, § 18-1101(d) (2005); id. § 17-1101(e).
106See id. § 18-305(g); id.§ 17-305(f).
107See id. § 18-402; id. § 17-402.
would be simpler to repeal the DGCL and amend section 18-102 of the LLC Act to permit the use of the word "Corporation" in the firm's name.\textsuperscript{108} Conversely, the fact that the Delaware corporation continues to be the dominant form of business entity in the nation, notwithstanding the greater freedom of contract provided by the LLC Act, suggests that parties find value in the corporate form in spite of its mandatory rules.

Additionally, the existence of greater freedom of contract under the LLC Act and the DRULPA substantially ameliorates (if not eliminates) the harm that would otherwise be suffered by parties who found that the arrangement they wished to enter into was prohibited by the DGCL. If, for instance, the parties decide that the optimal arrangement for their particular enterprise involves waiving any right of the investors to inspect books and records, they need not settle for a suboptimal arrangement.\textsuperscript{109} Rather, they may form an LLC and include such a provision in the LLC agreement.

By the same token, those who support mandatory terms must explain why it makes sense for the DGCL to include mandatory terms that the LLC Act and DRULPA do not. For instance, paternalism cannot explain why the DGCL prohibits parties from eliminating the duty of loyalty, when the same parties could accomplish the same objective by forming an LLC rather than a corporation. It cannot be that Delaware public policy prohibits investors from agreeing to entrust their money to fiduciaries who owe no duty of loyalty, because the LLC Act and the DRULPA permit exactly that. (The paternalism argument cannot be salvaged by arguing that Delaware corporations are often publicly held, because Delaware limited liability companies and limited partnerships may be publicly held as well.)

Similarly, the argument that mandatory terms benefit all by creating a predictable body of case precedent does not explain why parties are permitted to deviate from the mandatory rules simply by using a different form of entity. Whether firms choose to deviate from a default provision in the DGCL or are forced to form an LLC because the DGCL does not permit the desired deviation, in either case, the community of other Delaware corporations who choose not to deviate has lost the prospect of useful precedent.

In the end, we believe the strongest explanation for mandatory terms in the DGCL is branding. Merely by branding itself as a Delaware corporation, a firm can signal easily that it has certain core characteristics that provide basic


\textsuperscript{109}Butler & Ribstein, supra note 98, at 63.
protections to investors. Anyone contemplating buying shares of stock in a Delaware corporation can be confident, without having to obtain and examine the certificate of incorporation, that the directors of the corporation will be subject to a duty of loyalty; that stockholders will have the right to inspect corporate books and records for a proper purpose; and that the stockholders will have the right, periodically, to elect the directors.\textsuperscript{110} By contrast, anyone contemplating buying interests in a limited liability company or limited partnership can have no such confidence without carefully examining the governing agreement. Thus, if the core characteristics of the corporate form were not mandatory, the signaling value of the brand would be lost.

There can be little doubt that the "Delaware corporation" brand is enormously successful, particularly for publicly held and traded companies. In 2007, Delaware corporations comprised more than sixty-one percent of the Fortune 500 companies and more than fifty percent of the corporations listed on the NYSE, NASDAQ, and AMEX. Delaware's market share seems to be growing, as eighty-one percent of corporations that went public between 2003 and 2007 were Delaware corporations. By contrast, although there are hundreds of thousands of Delaware limited liability companies and limited partnerships, there are only eighty-eight limited liability companies and limited partnerships listed on national exchanges (eighty-three percent of which are Delaware entities).\textsuperscript{111} These figures corroborate the value of Delaware corporation brand as a signaling device to public investors.

Making directors' fiduciary duty of loyalty optional (for instance) would dilute the perceived quality of the "Delaware corporation" brand. Anyone contemplating an investment in a Delaware corporation would incur the costs of analyzing the certificate of incorporation to determine whether the directors' fiduciary duties were restricted or eliminated. Those costs would reduce the value of all Delaware corporations—even those that did not restrict or eliminate the duty of loyalty—because it would make it more expensive to invest in them.\textsuperscript{112} Professor Eisenberg explained:

> Persons who proposed to buy stock in a publicly held corporation therefore would either have to expend resources to determine whether the corporation was subject to all the core

\textsuperscript{110}See Coffee, Jr., supra note 6, at 1678 ("[S]tandardization of contract terms through the use of mandatory legal rules reduces information costs for investors.").

\textsuperscript{111}This data was provided to the authors by the office of the Delaware Secretary of State.

\textsuperscript{112}See Eisenberg, supra note 6, at 1522 (arguing that permitting the variation of core fiduciary and structural rules would "lead to inefficiency in the capital markets" and analogizing to the market for "lemons").
rules that constrain unfair self-dealing, shirking, and positional conflicts by top managers, or assume that all corporations had adopted variations of those core rules. Either course of action would render capital markets less efficient, because investors would either put less of their money into corporate securities or demand a higher return from such securities, than would otherwise be the case.\footnote{Id. at 1522-23.}

Professor Eisenberg recognized that this problem "might be ameliorated if corporations could reliably signal whether they had adopted variations from core fiduciary and structural rules," but did not see a mechanism for reliable signaling.\footnote{Id. at 1523 n.268.} It is the term "Delaware corporation" itself that provides the reliable signaling.

Contractarian scholars have recognized that uncertainty about novel terms in a certificate of incorporation may reduce the value of the corporation, but have argued that "the costs of uncertainty will be borne by the promoters who authored the nonstandard terms."\footnote{Macey, supra note 15, at 190. See also Gordon, supra note 6, at 1566-67 (noting that nonstandard terms in a certificate of incorporation produce costs that are borne by the promoters).} We believe that response misses the point, which is that the universe of "promoters" as a whole would welcome the opportunity to signal efficiently to investors that they have not deviated from certain important standard terms. The existence of mandatory rules associated with the particular entity called a "Delaware corporation" provides that opportunity.\footnote{But see Coffee, Jr., supra note 8, at 948-49.} Thus, mandatory rules reduce transaction costs for all Delaware corporations because investors in any Delaware corporation have less need to obtain and analyze the certificate of incorporation before investing.\footnote{Id.}

From a broader perspective that considers the full panoply of Delaware business entities, the mandatory rules in the Delaware corporation law are not truly mandatory.\footnote{Romano, supra note 5, at 1603.} Delaware provides a menu of entity options from which to

\footnote{See Butler & Ribstein, supra note 98, at 11 ("[T]he parties to a firm can opt out of terms that are mandatory for all corporations simply by choosing among different investment and governance.

\footnote{Id.}
choose, each with the benefits of limited liability. Parties who want to create an entity with self-perpetuating managers, no inspection rights, or no fiduciary duty of loyalty are entirely free to do so. They simply have to create a Delaware limited liability company. At the same time, parties who wish to create an entity offering those core investor protections can do so and efficiently signal those terms to investors by creating a Delaware corporation.

organizational forms.

119Id. at 19-20 ("Individuals choose among types of organization by comparing costs and benefits of forms, including the costs and benefits of delegating control to agents, so as to maximize their gains from engaging in a particular activity. Thus, we do not observe all economic activity being carried on through one type of organization. Instead, we observe millions of organizations of many types, sizes and structures.").