Contractarian Theory and Unilateral Bylaw Amendments

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ABSTRACT: Corporate directors have been utilizing a potent mechanism in dealing with shareholder activism and shareholder litigation: the right to unilaterally amend corporate bylaws. Directors have exercised this right, for instance, to impose various requirements on who can nominate a director or call a special shareholder meeting, or to designate an exclusive forum where the shareholders can bring suit. Based on the theory that corporate charters and bylaws constitute a "contract" between the shareholders and the corporation, courts have blessed many of the bylaws that directors have unilaterally adopted. This Article examines the contractarian theory by drawing a parallel between amending charters and bylaws on the one hand and amending contracts on the other; and by comparing the right to unilaterally amend corporate bylaws with the right to unilaterally modify contracts. The Article shows how contract law imposes various limitations on the modifying party's discretion. The Article also compares the standard contractual relationship with that of the shareholders and the corporation more generally and uncovers several important differences that could make shareholders (particularly, minority shareholders) more vulnerable to counterparty (directors' and controlling shareholder's) opportunism. For example, unlike contracting parties who have the right to terminate the contractual relationship or opt out of undesirable modifications, shareholders lack the right of termination or opt-out. As a possible solution, the Article considers various mechanisms, including giving the shareholders the right of

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optional redemption, more robust disclosure, the right to vote (including the right to elect or replace directors), and subjecting bylaw amendments to more active judicial oversight. The Article suggests that active judicial oversight, through the vigorous application of the proper and equitable purpose test or imposition of good faith and fair dealing obligations, would be better in retaining the desired flexibility and policing directors' and controlling shareholder's opportunism.

I. INTRODUCTION

Over roughly the past decade, corporate directors have been utilizing one of the most potent mechanisms in dealing with shareholder activism and shareholder litigation: the right to unilaterally amend corporate bylaws.[1] While corporate governance arrangements can be tailored using either the charter or the bylaws,[2] modifying the charter requires shareholder approval,[3] which can be time-consuming, costly, and uncertain.[4] On the other hand, directors can unilaterally amend the bylaws quickly, at a low cost, and with certainty: They can simply convene a board meeting and adopt a necessary

1. *See generally* Albert H. Choi, *Fee-Shifting and Shareholder Litigation*, 104 VA. L. REV. 59 (2018) (providing a brief overview about the concerns over deal-related shareholder litigation, perceived to be "out of control," and how that led corporations to adopt fee-shifting and exclusive forum bylaws); Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117 (2014) (discussing examples of directors' adopting advance notice bylaws in response to shareholder activism regarding director elections).

2. There are exceptions, however. For instance, whether to have a super-majority voting, to allow the directors to issue certain stock without shareholder approval ("blank check preferred provision"), to exempt directors from personal liability for breach of duty of care, or to have cumulative voting must be contained in the charter. *See* DEL. CODE ANN. tit. 8, §§ 102(a)(4), 102(b)(4), 102(b)(7), 214 (2018). A staggered (or classified) board provision, though it can be in the bylaws, requires a shareholder approval. *See id.* tit. 8, § 141(d).

3. *See id.* tit. 8, § 242; MODEL BUS. CORP. ACT § 10.03 (AM. BAR ASS'N, revised 2016). Charter amendment is considered to be a "fundamental" change to the corporation, thereby triggering shareholder approval requirement. When a proposed charter amendment "adversely affects" a certain class of shareholders, that class will get to vote on the proposal as a separate class. *See* DEL. CODE ANN. tit. 8, § 242(b)(2); MODEL BUS. CORP. ACT § 10.03. For a more detailed analysis of charter amendments, including the requirements and procedures under the federal securities laws, see generally Geeyoung Min, *Shareholder Voice in Corporate Charter Amendments*, 43 J. CORP. L. 289 (2018). For Delaware corporations, there is a small number of exceptions to the rule. Unless expressly prohibited by the charter, the directors can unilaterally change the name of the corporation, delete the names of the incorporators, or delete the provisions that were necessary to effect stock exchange, reclassification, etc., when such changes have become effective. *See* DEL. CODE ANN. tit. 8, § 241(b)(1); MODEL BUS. CORP. ACT § 10.05.

4. For a publicly traded company, the company will have to abide by the federal proxy regulation in securing shareholder approval. *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78(a) (2012); Securities Regulation Section 14A, 17 C.F.R. § 240.14a-8 (2011). Also, influential proxy advisory firms, such as Institutional Shareholder Services and Glass Lewis, have the policy of giving negative recommendations at the next director election when a firm adopts a charter provision (materially) adverse to the interests of shareholders, such as staggering the board. *See generally* Min, *supra* note 3 (providing a more detailed analysis). Notwithstanding this, there are instances where a charter amendment would be more advantageous, especially if the directors expect little or no shareholder resistance. Because they have the sole power to make an amendment proposal, they get to dictate the content and once the amendment has been adopted, shareholders will be unable to change it unilaterally. DEL. CODE ANN. tit. 8, § 242.

resolution[5] and bypass a shareholder vote.[6] Directors have deployed this power on numerous occasions. For example, many have attempted to better manage out-of-control shareholder litigation by requiring all shareholder lawsuits to be filed only in Delaware ("exclusive forum bylaw").[7] Similarly, some have adopted a bylaw that requires an activist shareholder to provide detailed information about itself and its director-nominees ("advance notice bylaw") to better prepare for a potentially costly proxy fight.[8] Other directors have shifted the corporation's litigation expenses onto unsuccessful (or not fully successful) plaintiff-shareholders ("fee-shifting bylaw").[9] Even when directors were adopting a bylaw provision in response to shareholders' demands, because they could dictate the contents of the bylaws, directors could devise a system that is potentially more favorable to them, while still showing fidelity to shareholder wishes.[10]

These bylaw amendments, while facially dealing more with process and rules issues,[11] can undoubtedly affect a shareholder's substantive rights. But

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5. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (granting broad authority to the board by stating that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation"); *Id.* tit. 8, §§ 141(b), (f) (stipulating minimum quorum requirement for a board resolution and allowing resolution through written or electronic communication).

6. The MBCA allows the directors to unilaterally amend bylaws while the DGCL requires a charter to have a granting provision. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109; MODEL BUS. CORP. ACT § 10.20. Almost all large, publicly traded corporations that are incorporated in Delaware have the express provision in their charters granting the right to amend bylaws to the directors. *See* Min, *supra* note 3, at 292. When both the shareholders and the directors have the right to unilaterally amend bylaws, it is not entirely clear whether the directors can unilaterally amend (or repeal) shareholder-adopted bylaws. The ambiguity stems from the fact that the statute expressly reserves the right of the shareholders to amend bylaws without consent or approval by the directors. *See infra* Part II.

7. *See* Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1640 (2016).

8. *See generally* Hamermesh, *supra* note 1 (providing a detailed analysis and examples of recently contested advanced notice bylaws).

9. Greatly alarmed by this development, the Delaware legislature amended the corporate statute to prohibit any fee-shifting mechanisms either in the bylaws or the charter. *See generally* Choi, *supra* note 1 (discussing fee-shifting); *see also infra* Section II.B (providing an overview of recently contested bylaws).

10. *See* Min, *supra* note 3, at 316. This is the idea behind "compromised implementation," where the directors, putatively in response to shareholders' (often repeated) requests to institute a certain corporate governance regime, would adopt a bylaw provision but with variation (or "compromise"). *Id.* at 313, 316–17.

11. *See* Gow v. Consol. Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933) ("[A]s the [certificate of incorporation] is an instrument in which the broad and general aspects of the corporate entity's existence and nature are defined, so the by-laws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for its convenient functioning to be laid down."); *see also* Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004) (citing *Gow*, 165 A. at 140) ("Traditionally, the bylaws have been the corporate instrument used to set forth the rules by which the corporate board conducts its business.").

when shareholders have challenged bylaws in court, the courts have relied on the contractarian principle to uphold the amendments. The Delaware Supreme Court's opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund* is exemplary.[12] While upholding a fee-shifting bylaw that the directors of ATP Tour, Inc. unilaterally adopted, the Court stated that the charter and bylaws constitute a "contract" between a corporation and its shareholders.[13] The court stated that the directors can amend the bylaws by adopting a fee-shifting provision because the ATP's charter grants the directors that right.[14] The Delaware Chancery Court applied similar reasoning when validating an exclusive forum bylaw in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*[15] The court stated that "the bylaws constitute a binding part of the *contract* between a Delaware corporation and its stockholders,"[16] and when the right to amend the bylaws has been granted to the directors the shareholders "will be bound by bylaws adopted unilaterally by their boards."[17]

To be accurate, the *ATP Tour* and *Boilermakers* courts did not state that the shareholders are stuck with the director-adopted bylaws. The *Boilermakers* court emphasized the fact that if the shareholders are displeased with the adopted bylaw provision, instead of challenging the provision's validity in court, they can either repeal the bylaw, adopt their own bylaw, or even remove

12. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

13. *Id.* at 557–58. According to the Court, "corporate bylaws are 'contracts among a corporation's shareholders.'" *Id.* at 558 (quoting Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d. 1182, 1188 (Del. 2010)). Due partly to concern over chilling even legitimate shareholder lawsuits, the Delaware Legislature later amended the corporate statute and prohibited fee-shifting provisions from being included either in the charter or the bylaws. *See* DEL. CODE ANN. tit. 8, §§ 109(b), 115 (2018); *see also infra* Part II for more detailed analysis.

14. *ATP Tour*, 91 A.3d at 560.

15. Boilermakers Local 154 Ret. Fund v. Chevron Corp, 73 A.3d 934 (Del. Ch. 2013). After the decision, there was even a debate about whether the directors can adopt a mandatory arbitration provision in the bylaws. *See generally* Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751 (2015) (analyzing the issues over mandatory arbitration clause in charters or bylaws and the problems of treating charters and bylaws literally as contracts); Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583 (2016) (discussing issues that arise when charters are treated like contracts). The issue over mandatory arbitration bylaws became moot when the Delaware Legislature amended the corporate statutes to allow forum selection clauses that designate Delaware but not other forums. *See* DEL. CODE ANN. tit. 8, § 115. *See generally* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUD. 31 (2017) (analyzing empirical data about corporations that adopted exclusive forum provisions either in their charters or bylaws); David Skeel, *The Bylaw Puzzle in Delaware Corporate Law*, 72 BUS. LAW. 1 (2016) (arguing that the Delaware legislature's decision to uphold an exclusive forum bylaw while disallowing a fee-shifting bylaw channeled more litigation back to Delaware, determining the direction of multi-forum litigation).

16. *Boilermakers*, 73 A.3d at 955 (emphasis added).

17. *Id.* at 956. According to the court, "a corporation's bylaws are part of an inherently flexible contract between the stockholders and the corporation under which the stockholders have powerful rights they can use to protect themselves if they do not want board-adopted forum selection bylaws to be part of the contract between themselves and the corporation." *Id.* at 957.

directors from the board (probably in the next election cycle).[18] Yet, the court imposed little restriction on the director's right to amend bylaws except perhaps where there is "fraud, undue influence, or overweening bargaining power."[19] In short, the court seems to indicate that the proper venue for working out disagreements and resolving agency issues is in the boardroom and not the courtroom.

The courts' reasoning in *ATP Tour* and *Boilermakers* raises some interesting questions. Does the courts' adoption of the contractarian principle, combined with the fact that shareholders grant directors the right to unilaterally amend bylaws, imply that there should be very little, if any, judicial check on directors' ability to unilaterally amend bylaws? What if company ownership is dispersed and the shareholders can easily sell their shares rather than try to amend the bylaws or wage a proxy fight to remove the current directors? Should the court more actively monitor board-amended bylaws in that case? What if a controlling shareholder (possibly with more than 50% of the voting power) adopts a bylaw through a shareholder resolution? More fundamentally, to the extent that we apply the contractual framework to charters and bylaws, what can we learn from how modification is treated under contract law? What about its treatment of unilateral modifications? What similarities or differences can we learn by comparing bylaws and charters with contracts? Finally, as a policy matter, should the directors or the shareholders be able to unilaterally amend bylaws with little or no oversight from the courts?

This Article's purpose is to shed light on these important issues. While the Article's primary focus is on unilateral bylaw amendments, it also deals

18. *Id.* at 941. According to the *Boilermakers* court:

> Thus, even though a board may, as is the case here, be granted authority to adopt bylaws, stockholders can check that authority by repealing board-adopted bylaws. And, of course, because the DGCL gives stockholders an annual opportunity to elect directors, stockholders have a potent tool to discipline boards who refuse to accede to a stockholder vote repealing a forum selection clause. Thus, a corporation's bylaws are part of an inherently flexible contract between the stockholders and the corporation under which the stockholders have powerful rights they can use to protect themselves if they do not want board-adopted forum selection bylaws to be part of the contract between themselves and the corporation.

Id. at 956–57 (citations omitted).

The court does not mention the fact that the displeased shareholders would rather sell their shares and discontinue their relationship with the company rather than waging a costly fight to either amend the bylaw or elect a new set of directors. *See generally id.* Especially for publicly traded corporations, such a robust "exit right" could substantially destroy an individual shareholder's incentive to engage more actively with any corporation's governance. See *infra* Part II for more detailed analysis.

19. *Boilermakers*, 73 A.3d at 957 (citing M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12 (1972)). Under Delaware jurisprudence, bylaw amendments are subject to judicial scrutiny according to the degree that their purpose is determined "proper" and "equitable." See *infra* Part II for a more detailed analysis.

generally with the amendment of both charters and bylaws. Our analysis draws from both agency and contract law.[20] Under agency law, when a principal and agent form a contract, like a retainer agreement between an attorney and a client, the court will determine the principal and agent's rights and obligations under contract using contract law (and not necessarily fiduciary) principles.[21] In that sense, the contractarian principle, that the charters and bylaws may be treated like a "contract," is broadly consistent with agency law principles. On the other hand, when we look at contract law, we discover that amending a contract is subject to various statutory and judicial restrictions. Probably the most relevant contract doctrine applicable to charter and bylaw amendment is the duty of good faith and fair dealing.[22] Contract modifications, including those that both parties voluntarily agreed to, must be done in good faith or be fair and equitable.[23] Even when a party exercises a contractually granted right to unilaterally modify the contract, as is often done in many consumer and commercial contracts, the party with the right to modify the contract must exercise it in good faith and must deal fairly with the counterparty. While different courts have constituted this duty with

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20. Professor John Coffee argued that we examine actual contract law to better understand a corporation's opting out of default rules through charter amendments. *See* 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, 924 (1988). According to Coffee, "[t]he risk of [managerial] opportunism is greatest when the charter provision is added by an amendment that shareholders do not fully understand," and to guard against such opportunistic amendments, Coffee suggests looking at contract law's regulation of modification, including the Restatement (Second) of Contracts section 89 that requires modification to be "fair and equitable in view of circumstances not anticipated by the parties when the contract was made." *Id.* at 938–39; RESTATEMENT (SECOND) OF CONTRACTS § 89 (AM. LAW INST. 1981). This Article expands this approach to both charter and bylaw amendments and also, more specifically, to unilateral bylaw amendments.

21. See *infra* Section II.A for a more detailed discussion.

22. Good faith duty under contract law should be distinguished from directors' good faith obligations to the corporation under corporate law. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2018). There used to be some uncertainty in Delaware case law as to what directors' good faith obligation entails and whether the obligation is separate from the other fiduciary duties of care and loyalty. Although, in theory, the courts could have harmonized the good faith obligation under corporate law with that under contract law, Delaware case law took a divergent approach by placing the good faith duty as part of the duty of loyalty. *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. . . . Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." (footnotes omitted)). *See generally*, David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491 (2004) (describing how Delaware courts have grappled with the "triad" fiduciary duties of care, loyalty, and good faith).

23. *See* U.C.C. § 2-209 (AM. LAW INST. & UNIF. LAW COMM'N 1977); RESTATEMENT (SECOND) OF CONTRACTS § 89 (AM. LAW INST. 1981); *see also* E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 4.22 (3d ed. 2004) (describing the common law contract requirements on contract modifications).

different elements, in the context of unilateral modifications, the most common requirements include the obligation (1) to disclose the proposed modification to the counterparty; (2) to grant the right to opt out of the proposed modification or terminate the contract; and (3) to not retroactively apply the modified provision.[24]

When we compare the rights of contracting parties with those of shareholders more broadly, we uncover several important factors that would make shareholders—particularly minority shareholders—more vulnerable than contracting parties. First, as other scholars note, even for charter (and bylaw) amendments that require express shareholder approval, for corporations with dispersed ownership, shareholders face collective action and rational apathy (or rational ignorance) problems.[25] When such problems become severe, the shareholder approval process provides little meaningful protection for investors against managerial opportunism. On the opposite end, when ownership is concentrated, for instance with a controlling shareholder who has more than 50% of the voting power, the collective action and rational apathy problems for the shareholders *as a class* may be absent, yet minority shareholders (and possibly also the directors and the officers)

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24. See *infra* Section II.B for further discussion.

25. Especially when a shareholder owns a diversified portfolio consisting possibly of thousands of stock and he or she can easily trade the shares on a national exchange, there would be very little incentive for the shareholder to engage with any specific company's governance issues. This is the problem of rational apathy or ignorance. *See* Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1824 (1989) (noting how voting shareholders have little incentive to be informed over charter amendment proposals—for instance, by studying the lengthy proxy material—and would remain uninformed or under-informed); *see also* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1573–85 (1989) (raising concerns over opportunistic mid-stream charter amendments due to collective action and other problems). Professors John Coffee and Roberta Romano have noted that shareholders' rational apathy does not necessarily mean that they will blindly vote in favor of management proposals. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1674–76 (1989); Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1607–12 (1989). The uninformed shareholders can, instead, vote against all management proposals (they can "just say no") or vote in favor of management proposals only some of the time (i.e., using a mixed strategy in game theory parlance). *Id.* at 1609. If shareholders were to always vote against management proposals, there would be too much rigidity in charter provisions. *See id.* at 1607–08. An important advantage of unilaterally amending the bylaws is, of course, that it does not require a shareholder approval and, hence, does not have to deal with shareholders' inherent skepticism. Although some have argued that the rise of institutional ownership, such as mutual and pension funds, has alleviated the collective action problem, the fact that the typical institutional shareholder will own a diversified portfolio, often consisting of thousands of stock, will likely prevent it from meaningfully engaging with any specific company or any specific issue. Institutional shareholders can turn to proxy advisory firms' (such as ISS and Glass Lewis) recommendations on how to vote their shares, but the advisory firms have also received the criticism that they lack sufficient interest in the company to make company-specific, tailored recommendations. *See generally* Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010) (questioning and empirically examining whether proxy advisory firms are as influential as believed).

may be harmed by the opportunism of the controlling shareholder.[26] Even worse, minority shareholders have little or no meaningful way to remove controlling shareholders or keep their powers in check.

Second, although the shareholders' right to receive amendment notification is relatively well-enforced under federal securities laws,[27] unlike in the contract setting, shareholders, particularly for publicly traded corporations, do not have the right to truly terminate their relationship with the corporation. Shareholders can always sell their stock, but the shareholder-corporation relationship remains preserved through the sale and the sale does not harm the corporation—at least not directly or immediately.[28] Third, the relationship between the directors and the shareholders, and between a controlling shareholder and the minority shareholders, is more vertical and hierarchical, based on agency notions, rather than horizontal and arms-length, as in an ordinary contractual relationship. Fourth, and more generally, whenever one party has the right to re-adjust or modify the relationship there is the possible danger of opportunism.

Building on these differences, with the lessons learned from contract law, we argue that there is a policy-based justification to be more vigilant against charter and bylaw amendments, and particularly against unilateral bylaw amendments either by the directors or the shareholders.[29] The policy goal should be to preserve flexibility in amending bylaws and charters while policing directors and controlling shareholders' opportunism. This Article considers various policy levers, including (1) optional redemption that allows a dissatisfied shareholder to sell the shares back to the company, (2) more robust disclosure to the shareholders (possibly before the amendment takes place), (3) more reliance on shareholder voting and approval, and (4) stronger judicial oversight. After considering the costs and benefits of each proposal, we suggest that the courts more vigorously apply the proper

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26. *See generally* Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53 (2018) (providing an overview of the recent rise of ownership concentration in the United States, particularly with dual class stock, and the problems of possible abuse).

27. *See infra* Part IV (describing, in part, how federal securities regulation requires an 8-K filing when a corporation's bylaw has been amended; it must be filed within four business days of the amendment).

28. *See infra* Part IV. A shareholder selling her stock is more akin to a contracting party assigning or delegating her right or obligation to a third party. The underlying contractual relationship is preserved.

29. The fact that the "contractual framework" is being applied to charters and bylaws does not mean that they should be literally treated as contracts subject to all doctrines of contract law. As a matter of fact, it is likely infeasible to apply all contract law doctrines to corporate organizational documents. *See* George S. Geis, *Ex-Ante Corporate Governance*, 41 J. CORP. L. 609, 612 (2016) (arguing that "corporate law should not outsource the resolution of ex-ante governance problems to generalized principles of contract law"); Lipton, *supra* note 15, at 586 (noting the dangers of treating charters and bylaws as contracts since the directors will be able to adopt mandatory arbitration provisions which must be enforced under the Federal Arbitration Act).

and equitable purpose or effect test under corporate law[30] and, borrowing from contract law, apply the good faith and fair dealing obligations in the bylaw and charter amendment context.[31] With stronger judicial oversight, we argue the flexibility benefits can be preserved while value-destroying hold-up and externality (by managers' or the controlling shareholder's exercise of discretion in "bad faith") can be better deterred.

The Article is organized as follows. Part I briefly reviews the statutory requirements of charter and bylaw amendments and recent developments in case law, highlighting how the courts, especially those in Delaware, have become more disposed to apply the contractarian principle to charters and bylaws. Part II focuses on the treatment of modifications, and particularly change-of-terms clauses in contract law. While the courts have utilized various doctrines in imposing restrictions against the possible abuse of the contract modification right—such as unconscionability, illusory promise (indefiniteness), good faith and fair dealing, and different canons of construction—Part II focuses primarily on the duty of good faith and fair dealing and shows how the application of this principle has often led to the duty of disclosure combined with the right to terminate the contract (or opt out of the proposed amendment). Part III compares the contract law regime with the corporate law regime and highlights important differences that can make shareholders more vulnerable to hold-up and counterparty opportunism. Part IV shows how the courts can remedy the hold-up and opportunism problem by more vigorously applying the equitable or proper purpose test as well as the good faith and fair dealing obligations to unilateral bylaw amendments. The Article argues that applying both concepts as

30. *See* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985) (stating that "bylaws must be reasonable in their application" and holding that bylaw amendments, which required unanimous approval for any board action, among others, done for the purpose of avoiding a majority shareholder's disenfranchisement, are valid); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 438 (Del. 1971) (holding that the directors' amending the bylaws and advancing a shareholder meeting date "for purpose of perpetuating itself in office and . . . for purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management" is "inequitable"). Although both *Schnell* and *Franz Mfg. Co.* devised and applied the proper and equitable (or reasonable) test fairly vigorously, as we will argue in Part V, courts more recently seem to have stepped away from such vigorous application, if they applied the test at all.

31. While we are in favor of borrowing and applying the implied obligation of good faith and fair dealing as a rule of interpretation, we do not advocate the wholesale incorporation of other contract law doctrines, such as unconscionability, indefiniteness, mutual assent, and various rules on remedy. This is consistent with the agency law principles. *See* RESTATEMENT (THIRD) OF AGENCY § 8.07 cmt. b (AM. LAW INST. 1981) (stating that "[c]ontract-law principles of general applicability govern whether such agreements are enforceable and how they are to be interpreted, among other questions."). Coffee (has made a similar argument in favor of judicial activism. According to Coffee, "[j]udicial activism is the necessary complement to contractual freedom" and comparing a corporation to a long-term, relational contract, "the court's role becomes that of preventing one party from exercising powers delegated to it for the mutual benefit of all shareholders for purely self-interested ends." Coffee, *supra* note 25, at 1621.

remedies not only advances the goal of preserving flexibility while policing opportunism (by the managers or the controlling shareholders), but it also harmonizes corporate law with principles laid out in both contract law and agency law. Part V concludes.

II. CORPORATE CONTRACT AND ITS AMENDMENT

The notion that a corporation's charter and bylaws can be thought of as a "contract" dates back to the U.S. Supreme Court case of *Trustees of Dartmouth College v. Woodward*.[32] Chief Justice Marshall stated that the Dartmouth College charter qualified as a "contract [among] the donors, the trustees, and the [British Crown]" and therefore was subject to the protection under the U.S. Constitution's Contract Clause.[33] Since this seminal case, both courts and scholars have espoused and extrapolated the contract notion of corporations.[34] Most notably, Jensen and Meckling, building on Ronald Coase's earlier work, argued that the corporation organization can be viewed as a "nexus of contract" and laid down a cornerstone for much of modern corporate law and finance scholarship.[35] Based in part on this contractarian

32. Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 518 (1819).

33. *Id.* at 643–44. "No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the *Obligation of Contracts*, or grant any Title of Nobility." U.S. CONST. art. I, § 10, cl. 1 (emphasis added).

34. *See, e.g.*, Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990) (stating that "[c]orporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply"); Ellingwood v. Wolf's Head Oil Ref. Co., 38 A.2d 743, 747 (Del. 1944) (stating that "the rights of stockholders are contract rights and [the court should] look to the certificate of incorporation to ascertain what those rights are"); Lawson v. Household Fin. Corp., 152 A. 723, 727 (Del. 1930) (stating that "since [*Dartmouth College*] . . . it has been generally recognized in this country that the charter of a corporation is a contract both between the corporation and the state and the corporation and its stockholders"); *see also* Berlin v. Emerald Partners, 552 A.2d 482, 488 (Del. 1989) (holding that contract interpretation rules apply when interpreting a certificate of incorporation); Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 342–43 (Del. 1983) (applying the rules "used to interpret statutes, contracts, and other written instruments" to construe corporate charters and bylaws).

35. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976) (stating that "most organizations are simply *legal fictions which serve as a nexus for a set of contracting relationships among individuals*" and that "[t]he private corporation or firm is simply one form of *legal fiction which serves as a nexus for contracting relationships*"). Jensen and Meckling make numerous inferences to Ronald Coase's earlier work. *See generally* R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). Numerous scholars have analyzed the theory over the years. *See, e.g.*, Michael Klausner, *The "Corporate Contract" Today*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 84, 85 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Bebchuk, *supra* note 25, at 1821; Coffee, *supra* note 25, at 1674–76; Coffee, *supra* note 20, at 924; James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 260–61 (2015); Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 715 (1997); Lipton, *supra* note 15, at 601–03; Jonathan G. Rohr, *Corporate Governance, Collective Action*

or nexus-of-contract theory, scholars have argued that corporate law should take a more enabling approach by minimizing the number of mandatory provisions and instead offer an optimal set of default ("off the rack") terms, and enforce parties' arrangements of their affairs ("private ordering") in charters and bylaws.[36] The premise is that rather than the state interfering with individual corporation's governance arrangements through one-size-fits-all mandatory terms, state law should instead allow each corporation to adopt its own optimal arrangements through private ordering.[37] Perhaps due to the contractarian theory's influence, corporate statutes—particularly Delaware statutes—require only a small number of provisions in the charter and leave the corporation with almost complete discretion with respect to the bylaws contents.[38] Section A will describe how state corporate statutes allow

and Contractual Freedom: Justifying Delaware's New Restrictions on Private Ordering, 41 DEL. J. CORP. L. 803, 807 (2017). The nexus of contract theory, while facially correct, is a bit misleading in the corporation and agency contexts. When two parties, e.g., a prospective client and a lawyer, enter into an agency relationship using a contract, obviously, the vertical relationship is based on and is created through a contract, but most of the post-formation issues, that are not expressly (or impliedly) dealt with in the contract, including amending the initial contract, can be subject of the agency law, rather than contract law, triggering additional obligations, such as fiduciary duty. One purpose of this Article is to deal with the issue of to what extent an agent can change the agency relationship when the right of modification is granted upon her in the initial agency contract. *See* Deborah A. DeMott, *Forum-Selection Bylaws Refracted Through an Agency Lens*, 57 ARIZ. L. REV. 269 (2015) (discussing the application of the agency law principles to unilaterally adopted forum-selection bylaws).

36. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1418 (1989) ("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."); Romano, *supra* 25, at 1615 (arguing that mandatory corporate law cannot be easily justified); *see also* Coffee, *supra* note 25, at 1621 (stating that the "stable mandatory core of corporate law [is] . . . the "institution of judicial oversight"). *But see* Gordon, *supra* note 25, at 1551–55 (doubting that full contractual freedom in corporate law will lead to private wealth maximization and advocating for some mandatory rules).

37. In terms of ensuring that the agreed-upon arrangements would be "optimal," scholars have invoked various market mechanisms, such as capital markets (firms with suboptimal governance arrangements would find it costlier to raise financing) and product market (inefficient firms will be driven out through product market competition). *See, e.g.*, Easterbrook & Fischel, *supra* note 36, at 1443.

38. *See, e.g.*, DEL. CODE. ANN. tit. 8, §§ 102(a), 109 (2018) (governing certificates of incorporation and bylaws, respectively); MODEL BUS. CORP. ACT §§ 2.02, 2.06 (2016) (AM. BAR. ASS'N, revised 2016) (same). At various sections in the Delaware code, for instance, expressly incorporate the phrase, "unless otherwise provided in the certificate of incorporation," and allows the parties to opt out of the default terms. *See, e.g.*, DEL. CODE. ANN. tit. 8, § 141(c)(3) (dealing with creation and power of subcommittees), § 212(a) (dealing with voting powers). Even the directors' managerial rights provision is subject to modifications in the charter. DGCL section 141(a) states: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided . . . in its certificate of incorporation." *Id.* § 141(a). With respect to the charter, the most important mandatory provision is the one on capital structure. Delaware law expressly allows

shareholders and directors to amend charters and bylaws, focusing, in particular, on unilateral amendment of bylaws. Section B will describe the recent case law development with respect to unilateral bylaw amendments.

A. Charter and Bylaw Amendment under Corporate Statutes

Perhaps consistent with this "enabling" approach, the corporation, subject to a few restrictions, can subsequently amend charters and bylaws as the directors and the shareholders see fit.[39] Both the Model Business Corporation Act and Delaware General Corporation Law ("DGCL"), at least with respect to charters, mandate a set of procedures that must be satisfied when a corporation wants to execute an amendment.[40] For instance, under DGCL section 242, only the directors can make a proposal to amend the charter[41] and, except for a small number of provisions, shareholders must expressly approve the proposal for the amendment to be effective.[42] Furthermore, under the Delaware statute, if a proposed amendment falls under one of three special categories, the most important being that the amendment adversely affects a class (or series) of shares, then the affected

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certain provisions in the charter and some of these are almost always included in the charters of publicly traded corporations. They are: (1) liability limitation for the directors and officers under DGCL section 102(b)(7); (2) granting the directors discretion to issue preferred stock ("blank check preferred provision") under DGCL section 102(a)(4); (3) right to amend bylaws under DGCL section 109(a); and (4) the right to change the number of authorized shares without a class vote under DGCL section 242(b)(2). This is not to say that the Delaware statute has fully embraced the contractarian theory. If we look outside the charter, there are various mandatory provisions, such as stockholders electing directors annually (section 211(b)); stockholders' right to vote by proxy (section 212(b)); and restrictions on having more than three classes on the board (section 141(d)). *See* Gordon, *supra* note 25, at 1553. With respect to the opting out hypothesis, Hansmann has argued that, due to various impediments, including draft (amending) costs and network externality, corporations are more likely to not opt out of default provisions and, instead, to "delegate" future amendments to state legislatures and courts. Hansmann, *supra* note 35, at 14–15. *See generally* Kahan & Klausner, *supra* note 35 (examining the network externality effects of corporate charter provisions).

39. At minimum, charter provisions must be "lawful and proper to insert in an original certificate of incorporation filed at the time of . . . the amendment." *See* DEL. CODE. ANN. tit. 8, § 241(a).

40. For a more detailed analysis of charter amendments, see generally Min, *supra* note 3 (discussing the theory underlying corporate charter amendments).

41. DGCL section 242(b)(1) states that the corporation's "board of directors shall adopt a resolution setting forth the amendment proposed, declaring its advisability, and either calling a special meeting of the stockholders entitled to vote . . . or directing that the amendment proposed be considered at the next annual meeting of the stockholders." DEL. CODE. ANN. tit. 8, § 242(b)(1). Hence, section 242 expressly endows the directors to make an amendment proposal while subjecting that proposal to shareholder approval. This is in contrast to procedures on bylaw amendment.

42. *Id.* § 242(b)(2). Charter amendment is considered to be a "fundamental" change to the corporation, thereby requiring shareholder approval; *see also* MODEL BUS. CORP. ACT ch. 10; *id.* ch. 11 intro. cmt. (describing "amendments to the articles of incorporation under chapter 10" of the MCBA as a "fundamental action").

class (or series) will get to vote on the amendment separately as a class.[43] Finally, neither the directors nor the shareholders can unilaterally amend the charter.[44]

Amending bylaws is a different matter. The Model Business Corporation Act ("MBCA") vests both the directors and the shareholders with the power to amend bylaws.[45] MBCA section 10.20(b) allows directors to amend the bylaws unless (1) the articles of incorporation reserve that power solely to the shareholders or (2) the shareholders amend the bylaw in question and stipulate in the bylaw that the directors cannot thereafter amend it.[46] For Delaware corporations the right to amend bylaws belongs to the shareholders, but it can be granted to the directors through a provision in the charter.[47] DGCL section 109(a) states that "the power to adopt, amend or repeal bylaws shall be in its members entitled to vote. Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors."[48] The statute imposes two important restrictions on the directors' power. First, it expressly preserves the shareholders' right to amend bylaws, which, with certain limitations, allows them to repeal or amend board-adopted bylaws.[49] Section 109(a) of the

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43. *See* DEL. CODE. ANN. tit. 8, § 242(b)(2). The other two categories of amendment that require a class vote are (1) changing the number of authorized shares and (2) changing the par value of the stock. *Id.* With respect to changing the number of authorized stock, however, if the original charter or the charter amendment that created the stock so provides, all shareholders can vote as a single class. *Id.* In addition to section 242, there is another way of amending the charter, through merger ("amendment through merger"). *See id.* § 251(e). Unlike section 242(b), however, section 251(e) does not mandate a class vote even when a certain class is adversely affected. *Id.*

44. *See supra* notes 41–42 and accompanying text.

45. MODEL BUS. CORP. ACT § 10.20 (2016) (AM. BAR ASS'N, revised 2016).

46. *Id.*

47. *See* DEL. CODE ANN. tit. 8, § 109(a).

48. *Id.* Amending bylaws is one of the few actions that the shareholders can initiate under Delaware law. Most of other "fundamental" changes to the corporation, such as charter amendment, merger, and sale of all or substantially all of the assets, expressly require a board resolution. *See, e.g.*, *id.* §§ 242(b), 251(b), 271(a). *See* Stephen Bainbridge, *Who Can Amend Corporate Bylaws*, PROFESSORBAINBRIDGE.COM (Jan. 5, 2006), http://www.professorbainbridge.com/professorbainbridgecom/2006/01/who-can-amend-corporate-bylaws.html.

49. Because Delaware law does not expressly stipulate that shareholders have the power to limit the board's right to amend (or repeal) shareholder-adopted bylaws, some commentators have noted that this raises the possibility of "cycling amendments and counter-amendments." Bainbridge, *supra* note 48. However, once the charter expressly grants directors the right to unilaterally amend bylaws, if shareholders were to try, through a provision in the bylaws, to prevent the board from amending or repealing shareholder-adopted bylaw, such a restriction would be inconsistent with the charter and likely invalid. *See* Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409, 467–75 (1998); *see also* Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1194–95 (Del. 2010) (invalidating a bylaw provision that advanced a shareholder meeting because it was inconsistent with the staggered board provision in the charter). There also are other legal and practical limitations. For instance, shareholders cannot adopt a bylaw that would interfere with the board's ability to manage the affairs of the corporation under DGCL section 141(a). *See* Jill E. Fisch,

Delaware statute states that "[t]he fact that such power has been so conferred upon the directors . . . shall not divest the stockholders . . . of the power, nor limit their power to adopt, amend or repeal bylaws."[50] Second, the statute places substantive and hierarchical limitations on amending the bylaws. Section 109(b) states that "[t]he bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[51] Thus, the bylaw must be consistent with state law and the corporation's charter and it must relate to the corporation's "business" or "affairs" or the rights of various constituents.

It is doubtful, however, whether the two restrictions the statute imposes could provide meaningful protection for the shareholders in practice. With respect to the first limitation, while in theory deciding whether the directors should have the power to unilaterally amend the bylaws is up to the shareholders, in practice almost all large, publicly traded corporations incorporated in Delaware have a granting clause in their charters.[52] This is not surprising. Perhaps directors should have the right to amend the bylaws, considering that most corporate charters do not contain detailed provisions relating to the corporation's business or affairs, nor do they stipulate the rights of various investors and other constituents. Ultimately, the directors have the authority to manage the corporation's business and affairs.[53] Furthermore, given that amending the charter is time-consuming and costly, due largely to the obligation of convening a shareholders' meeting, granting the directors such a right can better preserve flexibility for the corporation for unforeseen future contingencies and circumstances. Alternatively, this also creates a danger that the directors, as agents of the corporation and its shareholders, may abuse that discretion to the corporation and shareholder's detriment. As a matter of theory, it is unclear how much discretion directors should be given and what types of procedural or substantive checks must be imposed.

B. Recent Developments in Corporate Bylaws

Recently courts, especially in Delaware, have moved towards granting directors more freedom in unilaterally amending the bylaws. The idea that the bylaws, along with the charters, constitute a contract between the corporation and shareholders (and also among the shareholders) underlies

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Governance by Contract: The Implications for Corporate Bylaws, 106 CALIF. L. REV. 373, 383–87 (2018); Hamermesh, *supra*, at 415–16; D. Gordon Smith et al., *Private Ordering With Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 140 (2011).

50. DEL. CODE ANN. tit. 8, § 109(a).

51. *See id.* § 109(b).

52. *See* Min, *supra* note 3, at 294–99.

53. *See* DEL. CODE ANN. tit. 8, § 141(a).

this trend. Once the shareholders grant the directors the right to unilaterally amend the bylaws under DGCL section 109(a), the directors can go ahead and exercise that right. Under this theory the shareholders have, at least implicitly, agreed to such unilateral changes by including the granting provision in the charter.[54] If shareholders are displeased with such changes, they can either amend the charter and take the director's right away or possibly unilaterally repeal or amend the bylaw provision the directors adopted. In theory, the shareholders have procedural mechanisms to protect their rights against potential abuse by the board. Perhaps these mechanisms require little or no judicial oversight; shareholders and directors should be able to privately order their affairs with minimal intervention from courts.[55]

Directors have been fairly active in deploying this power. Recently they have unilaterally amended bylaws to include: (1) advance notice provisions requiring shareholders to provide detailed information to the board about their upcoming proposals (including possible proxy fights) during a specified window before the shareholders meeting; (2) exclusive forum provisions requiring prospective plaintiff-shareholders to bring corporate law-based suit only in Delaware; (3) special shareholder meeting provisions that allow only a shareholder with substantial share ownership (often 5% or more) to call a special shareholders' meeting; and (4) fee-shifting provisions that require non-prevailing shareholders to reimburse all the fees and expenses that the corporation and its directors have incurred in the dispute.[56]

1. *Boilermakers* and *ATP Tour*

Although it was initially uncertain whether the court would uphold the unilaterally adopted bylaws, Delaware courts have sided with the directors, particularly with respect to bylaws dealing with shareholder litigation. The *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*[57] case is exemplary. The directors of Chevron and FedEx adopted exclusive forum bylaws that required shareholders to initiate corporate law-based litigation only in Delaware.[58] In relevant parts, the bylaw stated:

> Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action

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54. The Chancery Court in *Boilermakers* called this an "implied consent." Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 955–56 (Del. Ch. 2013).

55. The idea that the shareholders and the directors should be able to privately order their affairs with minimal judicial intrusion seems to underlie the courts' reasoning that upheld unilateral bylaw changes.

56. For an overview of recently contested bylaws, see generally Choi, *supra* note 1, at 60–67; Fisch, *supra* note 49, at 374–77; Hamermesh, *supra* note 1, at 118–24; Min, *supra* note 3, at 294–95.

57. *Boilermakers*, 73 A.3d 934 (Del. Ch. 2013).

58. *Id.* at 939.

> asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].[59]

Without the application of such a bylaw, shareholders presumably would be able to bring suit against the corporation or the directors (and officers) under the rules of civil procedure, for instance, in the state of incorporation or the state where the corporation's headquarters is located, or both.

When the shareholders challenged the exclusive forum bylaw, the Chancery Court upheld its facial validity.[60] The court reasoned that "the bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders" and the bylaw dealing with litigation forum is a proper subject matter under DGCL section 109(b).[61] The court stated that when the shareholders grant the directors the right to unilaterally amend the bylaws in the charter, they have "assented to a *contractual framework* established by the DGCL and the certificates of incorporation that explicitly recognizes that stockholders will be bound by bylaws adopted unilaterally by their boards," and "[u]nder that clear *contractual framework*, the stockholders assent to not having to assent to board-adopted bylaws."[62] According to the court, in case the shareholders are displeased with a board-adopted bylaw, instead of filing a shareholder lawsuit they can either repeal or amend the board-adopted bylaw, or even remove the directors at the next shareholders' meeting.[63] This reasoning strongly implies that the dispute over board-adopted bylaws should be resolved in the boardroom rather than in the courtroom.

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59. *Id.* at 942 (quoting Chevron Complaint at ¶21).

60. *See Boilermakers*, 73 A.3d at 955–56.

61. *Id.* at 955.

62. *Id.* at 956 (emphasis added). In an earlier case, the federal district court in California ruled that unilaterally adopted forum selection bylaw is invalid under the principles of contract law. Galaviz v. Berg, 763 F. Supp. 2d 1170, 1171 (N.D. Cal. 2011). The court stated that "[u]nder contract law, a party's consent to a written agreement may serve as consent to all the terms therein, whether or not all of them were specifically negotiated or even read, but it does not follow that a contracting party may thereafter unilaterally add or modify contractual provisions." *Id.* at 1174. The Boilermakers court criticized this reasoning, stating that the conclusion "rests on a failure to appreciate the contractual framework established by the DGCL for Delaware corporations and their stockholders." *Boilermakers*, 73 A.3d at 956 (emphasis added).

63. *Boilermakers*, 73 A.3d at 956.

Furthermore, while mentioning that the bylaws should be "interpreted using contractual principles,"[64] the court relied on a couple U.S. Supreme Court cases, *The Bremen v. Zapata Off-shore Co.*[65] and *Carnival Cruise Line v. Shute*,[66] which validated forum selection clauses. Citing *Bremen*, the *Boilermakers* court held that the forum selection clauses are valid so long as they are "unaffected by fraud, undue influence, or overweening bargaining power," and that the provisions "should be enforced unless enforcement is shown by the resisting party to be 'unreasonable.'"[67] Hence, while the court did attempt to examine both the procedural and substantive aspects of the adoption of the forum selection bylaw, examining the issues of "fraud, undue influence, or overweening bargaining power" and whether the provision's enforcement would be "unreasonable" would still leave directors plenty of latitude.[68] In fact, in *ATP Tour Inc. v. Deutscher Tennis Bund*,[69] the case that validated fee-shifting bylaws, there was little mention of whether the bylaws should be examined under the principles of contract even though the decision relied heavily on the contractarian principle.[70] Taken together,

64. *Id.* at 957.

65. M/S Bremen v. Zapata Off-shore Co., 407 U.S. 1 (1972).

66. Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991).

67. *Boilermakers*, 73 A.3d at 957 (citing *M/S Bremen*, 407 U.S. at 9).

68. *Id.* The *Boilermakers* court stated:

> [T]he plaintiff may sue in her preferred forum and respond to the defendant's motion to dismiss for improper venue by arguing that . . . the forum selection clause should not be respected because its application would be unreasonable. The plaintiff may also argue that . . . the forum selection clause should not be enforced because the bylaw was being used for improper purposes inconsistent with the directors' fiduciary duties.

Id. at 958 (footnote omitted). The court also states that the bylaws are presumed to be valid and to successfully challenge the "facial statutory and contractual validity of the bylaws," the plaintiffs must show that "the bylaws cannot operate lawfully or equitably *under any circumstances*." *Id.* at 948. The *ATP Tour* court similarly states that the fact that "under some circumstances, a bylaw might conflict with a statute, or operate unlawfully, is not a ground for finding it facially invalid." ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014). This line of analysis, however, is in tension with an earlier ruling by the Delaware Supreme Court. In *CA, Inc. v. AFSCME Employees Pension Plan*, the Delaware Supreme Court struck down a bylaw that would require reimbursement of proxy expenses (of the insurgent shareholders) by finding that complying with the bylaw will lead to a breach of directors' fiduciary duties under "at least one . . . hypothetical." CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238 (Del. 2008).

69. *ATP Tour*, 91 A.3d at 554. While the *ATP Tour* court does mention the requirement that the amendment must be done for a "proper" or "equitable" purpose (and effect), it does not delve more into the purpose behind the fee-shifting bylaws. According to the court, "the enforceability of a facially valid bylaw may turn on the circumstances surrounding its adoption and use," but the certification from the U.S. Third Circuit Court "does not provide the stipulated facts necessary to determine whether the ATP bylaw was enacted for a proper purpose or properly applied." *Id.* at 559.The court nevertheless states that the "intent to deter [shareholder] litigation . . . is not invariably an improper purpose." *Id.* at 560.

70. There are a few areas in which a bylaw amendment will be subject a heightened judicial scrutiny. If the directors were adopting a bylaw with an anti-takeover feature against a hostile

Boilermakers and *ATP Tour* espoused the principle of minimal judicial interference when corporate directors exercise their charter-granted right to unilaterally amend bylaws.

2. Subsequent Developments

Buoyed by judicial endorsement, it is not surprising that corporate directors and practitioners began experimenting with other types of bylaws. In *City of Providence v. First Citizens Bancshares, Inc.*,[71] the defendant-directors of a Delaware corporation adopted a forum selection bylaw that required shareholders to bring suit only in the state of the corporate headquarters, North Carolina.[72] The Delaware Chancery court, citing *Boilermakers* and relying on the contractarian principle, upheld the bylaw.[73] At the same time, practitioners were also experimenting with the idea of adopting a mandatory arbitration bylaw with or without a class arbitration waiver.[74] Commonwealth REIT, a publicly traded Maryland real estate investment trust, adopted and attempted to enforce a mandatory arbitration clause.[75] The state circuit court in Maryland, citing *Boilermakers*, upheld its enforceability.[76] On the fee-shifting front, encouraged by the *ATP Tour* holding, some commentators have even suggested corporations implementing "no pay" bylaws, which would prohibit defendant-corporations from paying plaintiff-attorney's fees.[77] Although we

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takeover attempt, the bylaw amendment will likely be scrutinized under the *Unocal* proportionality standard. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Also, if the directors are deemed to interfere with the shareholder franchise, the bylaw will be subject to the *Blasius* compelling justification test. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

71. City of Providence v. First Citizens Bancshares, Inc., 99 A.3d 229 (Del. Ch. 2014).

72. *Id.* at 230.

73. *Id.* at 230–31.

74. *See* Allen, *supra* note 15, at 805–08; Matthew C. Baltay, *Exclusive Forum Bylaws Are Going Mainstream: What's Next, Bylaws Eliminating Shareholder Class Actions?*, 59 BOS. B. J. 28, 32–33 (2015).

75. Corvex Mgmt. LP v. Commonwealth REIT, No. 24-C-13-001111, 2013 WL 1915769, at *4 (Md. Cir. Ct. May 8, 2013).

76. *Id.* at *27; *see also* Del. Cty. Emps. Ret. Fund v. Portnoy, Civil Action No. 13–10405–DJC, 2014 WL 1271528, at *5–6 (D. Mass. March 26, 2014) (dismissing plaintiffs' challenge against the mandatory arbitration bylaw of Commonwealth REIT based on res judicata principles).

77. *See* Sean J. Griffith, *Private Ordering Post-Trulia: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES (Steven Davidoff Solomon & Randall S. Thomas, eds.) (forthcoming 2019); A. Thompson Bayliss, *"No Pay" Provisions: The Forgotten Middle Ground in The Fee-Shifting Battle*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (June 1, 2015), https://corpgov.law.harvard.edu/2015/06/01/no-pay-provisions-the-forgotten-middle-ground-in-the-fee-shifting-battle. Since a "no pay" bylaw does not shift the corporation's expenses onto the plaintiff-stockholders, this would not be in violation of the Delaware statute prohibiting fee-shifting bylaws. Another possibility is to shift the fees onto the shareholder-plaintiff's counsel or any third-party entity that aids the plaintiff-shareholder. The Delaware statute only prohibits making the shareholder responsible for the corporation's fees. *See* DEL. CODE ANN. tit. 8, §§ 102(b)(6), 109(b) (2018). Although subsequent cases have attempted to impose corporation's litigation expenses onto the shareholders but conditioned it on other criteria, such as when suit was brought in violation of the company's exclusive forum bylaw, given that the plaintiff-shareholders are responsible for the expenses, none seems to have

can only speculate, if the contractarian principle were to hold and apply as in *Boilermarkers* and *ATP Tour*, one could make a persuasive argument that a mandatory arbitration clause or a "no pay" clause should also be binding against the shareholders.[78] After all, to the extent that the directors can validly require the shareholders to bring suit in a certain jurisdiction or impose litigation costs on plaintiff-shareholders, there could be little reason to disallow the directors from forcing the shareholders to arbitrate their claims or committing not to pay the plaintiff-shareholders' litigation costs.

On the advance notice and other bylaws, some corporate directors have begun to test the contractarian principle's limits by imposing extensive information and qualification requirements before a shareholder can either call a special meeting of shareholders or nominate a director. For instance, Allergan (known for its production and sale of Botox) adopted a bylaw, putatively with shareholder approval, that required any shareholder that wants to call a special shareholder meeting to disclose all of its (along with its "associates" and "affiliates") trading history.[79] On the director qualification issue, HopFed Bancorp, a banking corporation headquartered in Hopkinsville, Kentucky, through its bylaws, imposed a director qualification requirement that any director candidate cannot be associated with any entity that has been subject to any kind of investigation or consent order from a regulatory agency (including the SEC).[80] The qualification requirement

succeeded. *See, e.g.*, Solak v. Sarowitz, 153 A.3d 729, 741 (Del. Ch. 2016) (declaring that section 109(b) prohibits "*any provision*" that shifts the expenses to the shareholders in litigation dealing with an internal corporate claim).

78. We suspect that this (including disallowing mandatory arbitration) might have been one of the primary motivations behind the Delaware Legislature's prohibition of fee-shifting provisions and requiring Delaware to be the exclusive forum. *See* DEL. CODE ANN. tit. 8, §§ 109(b), 115; Skeel, *supra* note 15, at 9.

79. *See* Steven Davidoff Solomon, *Allergan-Valeant Fight Holds Lessons for All Corporate Shareholders*, N.Y. TIMES: DEALBOOK (Sept. 18, 2014, 4:05 PM), https://dealbook.nytimes.com/2014/09/18/allergan-valeant-fight-holds-lessons-for-all-corporate-shareholders. Allergan's bylaws already required only the shareholders that own more than 25% of the outstanding stock could call a special shareholder's meeting. *See* Counterclaims of Valeant & Pershing Square at 8, Allergan, Inc. v. Valeant Pharmaceuticals, No. 8:14-cv-01214, 2014 WL 4661003 (C.D. Cal Aug. 19, 2014). Allergan's argument was that this bylaw was "approved" by the shareholders when Allergan submitted a charter amendment proposal for shareholder approval, on August 8, 2014, because company also disclosed the bylaw amendment, which did not require a shareholder approval. *See* Complaint for Violations of Securities Laws, Allergan, Inc. v. Valeant Pharmaceuticals, No. 8:14-cv-01214, 2014 WL 3809192 (C.D. Cal, Aug. 1, 2014). In terms of who can call a special meeting of shareholders, Delaware statute is quite open-ended. The Delaware code states only that "[s]pecial meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws." DEL. CODE ANN. tit. 8, § 211(d).

80. Vince Sullivan, *Investor Says Ky. Bank is Preventing Director Nominations*, LAW360 (May 10, 2017, 7:28 P.M.), https://www.law360.com/articles/922722/investor-says-ky-bank-is-preventing-director-nominations. The debate over how much restrictions a Delaware corporation can impose on director candidates is magnified by the fact that, like the provision on special shareholder meetings, the statute is relatively silent on the issue. DGCL section 141(b) only states:

seemed to be surgically directed at Stilwell Associates LP, an activist hedge fund that was waging a proxy fight against the bank and about to nominate Joseph Stilwell, who had previously entered into a consent decree with the SEC.[81] While it may have been possible for the court to strike down both of these bylaws for being unreasonable or unduly restrictive,[82] both cases settled before the court could make a decision on their merits.[83] Taken together, applying the contractarian principle to corporate charters and bylaws, Delaware courts have firmly been on the path of expanding the directors' (and shareholders') right to unilaterally adopt bylaws when such right is granted in charter.

III. AGENCY AND CONTRACT LAW IMPLICATIONS ON CORPORATE CONTRACT

The adoption of the contractarian principle to a corporation's charter and bylaws naturally leads us to think about how modification of such "contracts" would be dealt with under either agency law or contract law. To the extent that the relationship between the directors and the shareholders (and even between controlling shareholders and minority shareholders) invokes agency principles, one could examine the amendment issue using either fiduciary duty (such as duty of care and duty of loyalty, including the duty of good faith) or interpretation rules of contract law. Under contract law, modification generally raises at least two important issues: (1) whether the parties have assented to the modification (the manifestation of mutual assent requirement);[84] and (2) whether a modification is fair and equitable or made

"Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. The certificate of incorporation or bylaws may prescribe other *qualifications* for directors." DEL. CODE ANN. tit. 8, § 141(b) (emphasis added). The statute, therefore, seems to grant a wide latitude to the directors (and the shareholders) in imposing various qualification limitations on director-nominees. Another important issue is that the statute does not expressly stipulate who can make a director nomination. See Hamermesh, *supra* note 1, at 121–24, for more detailed analysis.

81. Verified Complaint for Declaratory and Injunctive Relief, Stillwell Assocs., L.P. v. HopFed Bancorp, Inc., No. 2017-0343-JTL (Del. Ch. May 9, 2017).

82. For instance, in the Allergan case, Chancellor Bouchard called the information requirement "quite a horse-choker of a bylaw." At the same time, the defense counsel was willing to defend the bylaw based on the argument that the Allergan shareholders approved its adoption. *See supra* note 79.

83. An important aspect about advance notice bylaws is that because they deal with the shareholder franchise, for instance in terms of right to nominate directors, call special meetings, or adopt a written consent, they are likely be subject to an enhanced judicial scrutiny, notably under *Blasius*. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988). This distinguishes them from other types of bylaws, including litigation bylaws, which do not necessarily interfere with the shareholder franchise.

84. On the problems of constructing "consent" (or the manifestation of mutual assent) in the case of corporate charter and bylaw amendments, see Lipton, *supra* note 15, at 612, and DeMott, *supra* note 35, at 282.

in good faith.[85] This Part first briefly discusses agency law's treatment of principal-agent contract and then examines the unilateral modification problem through contract law in more detail.

A. AGENCY LAW'S TREATMENT OF PRINCIPAL-AGENT CONTRACT

Once we determine that the charters and bylaws constitute a "contract" among the shareholders, directors, and the corporation, the preliminary issue that arises is whether courts should use the principles of contract law or those of fiduciary law to deal with the scope and content of such "contractual" obligations. For instance, in terms of interpreting the provisions of charters or bylaws, the directors (and the shareholders) could theoretically be subject to either the interpretation rules of contract law or to fiduciary duty principles. If contract law rules were to apply, the court will try to determine the parties' "intent" using textual and extrinsic evidence and will not a priori interpret the language in one party's (for instance the shareholder's) favor. On the other hand, if we applied fiduciary obligations, unilateral bylaw amendments are most likely to receive business judgment rule protection unless enhanced judicial scrutiny, such as the entire fairness rule or the *Unocal* proportionality test, would apply.[86]

Although corporate law is unclear on this issue, to the extent that the principal and the agent have decided to stipulate each party's rights and obligations using a contract and (implicitly) carve out fiduciary rules, it seems appropriate to deal with the scope and content of such contractual obligations using the principles of contract law rather than those of fiduciary law. In fact, this is the approach taken in agency law.[87] According to section 8.07 of Restatement (Third) of Agency titled "Duty Created by Contract," "[a]n agent has a duty to act in accordance with the express and implied terms of any contract between the agent and the principal."[88] The official comment to the section goes on to state that "[a]lthough a contract is not necessary to create a relationship of agency, many agents and principals enter into agreements. Contract-law principles of general applicability govern whether such agreements are enforceable and *how they are to be interpreted*, among other

85. Fair and equitable requirement is imposed by the Restatement while the Uniform Commercial Code uses the good faith approach. *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 89(a) (AM. LAW INST. 1981), *with* U.C.C. § 2-209 (AM. LAW INST. & UNIF. LAW COMM'N 2017).

86. With the business judgment rule protection, because the plaintiff-shareholders must show that the directors were "grossly negligent" when amending the bylaws, this seems more deferential to the directors' decisions than the contractual duty of good faith and fair dealing.

87. *See* RESTATEMENT (THIRD) OF AGENCY §§ 8.07, 8.13 (AM. LAW INST. 2006). For cases that apply contract law principles to principal-agent contracts, see ADA Sols, Inc. v. Meadors, 98 F. Supp. 3d 240 (D. Mass 2015); United States v. Whitman, 904 F. Supp. 2d 363 (S.D.N.Y. 2012); Estate of Vizenor v. Brown, 851 N.W.2d 119 (N.D. 2014); and Nat'l Plan Adm'rs, Inc. v. Nat'l Health Ins. Co., 235 S.W.3d 695 (Tex. 2007).

88. RESTATEMENT (THIRD) OF AGENCY § 8.07.

questions."[89] At the same time, given that the principal-agent relationship is operating in the background, and to the extent that the contract leaves gaps, it would seem more appropriate to deal with such gaps using fiduciary obligations rather than with the rules of contract interpretation.[90]

B. How Contract Law Deals with (Unilateral) Modification

Turning to contract law, granting directors (or the shareholders) the right to unilaterally amend bylaws is akin to giving one party to a contract the right to unilaterally amend (or modify) the contract.[91] These are often called change-of-terms clauses, and such provisions are prevalent particularly in consumer and employment contracts including credit card agreements and end user license agreements ("EULA"). They are also visible in agreements among commercially sophisticated entities, including the cases where one party has the right to determine the price or the quantity in a sales contract.[92] In addition to the good faith and manifestation of mutual assent issues that apply broadly to all contract modifications, the change-of-terms clause raises other issues: (1) whether the right is so open-ended as to make the contract (or the promise) illusory or too indefinite; (2) whether the right grants too much power to one party so as to make the term unconscionable; (3) what the parties might have intended by granting one party to unilaterally modify the contract (the question of contractual intent); and (4) in case the right is exercised, whether the exercise is in good faith and the modifying party is dealing fairly with the counter party.[93] This Section will first briefly review

89. *See id.* § 8.07 cmt. b (emphasis added).

90. Under contract law, courts will attempt to find the contractual rights and obligations from the express language of the contract rather than finding them through some open-ended obligations. The implied duty of good faith and fair dealing, therefore, is used more as an interpretation, rather than a gap-filling, tool. This is in contrast to how agency law operates: Even when an express agency contract is completely silent, courts will impose fiduciary obligations on the agent.

91. An important difference is that under contract law, unless the contract stipulates otherwise, no party is given the right to unilaterally modify the contract. *See supra* note 23 and accompanying text. By contrast, under corporate law, shareholders always have the right to unilaterally modify bylaws. *See supra* notes 47–48 and accompanying text. Technically, there is also a difference between having a change-in-terms clause in a contract versus a right to unilaterally amend bylaws in the charter, since the relationship between the charter and the bylaws is hierarchical. We doubt, however, that these differences would matter much, unless the bylaw provision in question is in conflict with the charter. For instance, even if the statute would have allowed a granting clause to be contained in the shareholder-approved bylaws, rather than the charter, unless there is another provision in the charter with which it conflicts, it seems unlikely that the court would have come to a different conclusion.

92. The most common commercial agreements that allow one party to dictate the terms of the transaction are output and requirements contracts as well as open-price contracts, which allow either the buyer or the seller to determine, ex post, the quantity or price of the good to be produced. *See* U.C.C. §§ 2-209, 2-306 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

93. There also is a question of whether there is mutual assent to the unilateral modification. This issue arises most often with respect to consumer contracts, when, for instance, the notification is sent through a bill stuffer. One reason why the courts often required a meaningful

these issues in turn and will show that by cobbling together different doctrinal frameworks under contract law courts have imposed a substantial restriction on how the contractually granted right can be exercised.

1. Illusory Promise and Indefiniteness

Under contract law, granting one contracting party too much flexibility can lead to a lack of commitment and a presence of commitment (a promissory element) is essential for there to be a contract.[94] The unilateral right to amend a contract can raise an analogous problem.[95] When the parties expressly subject the unilateral modification right with certain obligations, such as a duty to provide advance written notice to the counter party, on the other hand, courts have held that the right of unilateral modification is no longer illusory.[96] For instance, with an advance notice provision, the party with the right to modify the contract no longer has unfettered discretion and is committing to a certain course of action (i.e., showing commitment necessary to construct a promise).

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opt out (or termination) was to satisfy the mutual assent requirement. *See generally* Peter A. Alces & Michael M. Greenfield, *They Can Do What!? Limitations on the Use of Change-of-Terms Clauses*, 26 GA. ST. U. L. REV. 1099 (2010) (surveying the numerous contexts in which change-of-terms clauses are used, especially when used to facilitate a series of transactions); Oren Bar-Gill & Kevin Davis, *Empty Promises*, 83 S. CAL. L. REV. 985 (2010) (expressing concerns over contracts that allow only sellers to unilaterally modify contractual terms and proposing "Change Approval Boards" as a remedy); David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. REV. 605 (2010) (examining unilateral amendment provisions according to how frequently they are used and criticizing aspects of both traditional conservative and liberal theories of contract procedure). The Articles ultimately argue for a statutory mechanism to deal with commercial entities arbitrarily modifying their contracts with consumers. *See* Michael L. DeMichele & Richard A. Bales, *Unilateral-Modification Provisions in Employment Arbitration Agreements*, 24 HOFSTRA LAB. & EMP. L.J. 63 (2006) (arguing that unrestricted rights for employers to choose arbitration or not should not be altered by courts).

94. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 1, 2 (AM. LAW INST. 1981). When there is no commitment and therefore, no promise, the contract also lacks consideration. Accordingly, some courts treat the illusory promise problem as a lack of consideration problem. *See supra* note 67 and accompanying text.

95. *See, e.g.*, Dumais v. Am. Golf Corp., 299 F.3d 1216, 1219–20 (10th Cir. 2002) (agreeing with other circuits that "an arbitration agreement allowing one party the unfettered right to alter the arbitration agreement's existence or its scope is illusory"); Floss v. Ryan's Family Steak House, Inc., 211 F.3d 306, 315–16 (6th Cir. 2000) (finding that promise to provide for arbitral forum in contract was illusory); Cheek v. United Healthcare of the Mid-Atlantic, Inc., 835 A.2d 656, 662–64 (Md. 2003) (finding a change-of-terms clause in an employee handbook illusory and declining to enforce an arbitration clause later added by the employer).

96. *See* Pearson's Pharmacy, Inc. v. Express Scripts, Inc., No. 3:06-CV-73-WKW [WO], 2009 WL 3623395, at *2,*9 (M.D. Ala. Oct. 29, 2009) (holding that the change-of-terms clause that required Express Scripts to provide written notice of any modifications and to give the pharmacy an option to terminate the contract if they disagreed with the changes was valid); Morrison v. Circuit City Stores, Inc., 70 F. Supp. 2d 815, 823 (S.D. Ohio 1999) (finding valid a change-of-terms clause with an obligation to give advance notice when the right could be exercised only at certain times of the year).

In re Halliburton is informative.[97] In the case, Brown & Root Energy Services, a Haliburton subsidiary, unilaterally adopted a Dispute Resolution Program subjecting its employees to binding arbitration in resolving all disputes.[98] The company sent a notice of the program to all the employees in November 1997.[99] The notice also informed the employees that by continuing to work at the company they would be accepting the new program.[100]

Myers, the plaintiff, challenged the binding arbitration clause in court, arguing, among other things, that the employer's initial employment promise illusory because the company retained the right to modify or discontinue (terminate) the program.[101] The Texas Supreme Court, applying Texas contract law, held that the arbitration clause was valid.[102] Particularly with respect to the illusory promise claim, the Court stated:

> [T]he Program also provided that "no amendment shall apply to a Dispute of which the Sponsor [Halliburton] had actual notice on the date of amendment." As to termination, the plan stated that "termination shall not be effective until 10 days after reasonable notice of termination is given to Employees or as to Disputes which arose prior to the date of termination." Therefore, Halliburton cannot avoid its promise to arbitrate by amending the provision or terminating it altogether.[103]

Thus, the promise to arbitrate was no longer illusory when the employer committed to not modify or terminate the program without a 10-day notice and also committed to non-retroactivity.

97. *In re* Halliburton Co., 80 S.W.3d 566 (Tex. 2002). Allowing consumers to have the chance to opt out by terminating the contract has been deemed to better satisfy the requirement of mutual assent to the proposed unilateral amendment. *See* Stiles v. Home Cable Concepts, Inc., 994 F. Supp. 1410, 1416–18 (M.D. Ala. 1998). The non-retroactivity clause combined with notice provision is often called the *Halliburton* "savings clause." *See In re* 24R, Inc., 324 S.W.3d 564, 567 (Tex. 2010) (explaining that the *Halliburton* court "held that because the [amended arbitration agreement] contained a 'savings clause'—including a ten-day notice provision and a provision that any amendments would only apply prospectively—that prevented the employer from avoiding its promise, the arbitration agreement was not illusory"). See *Nelson v. Watch House Int'l, LLC*, 815 F.3d 190, 193–94 (5th Cir. 2016), for a recent application of the Halliburton savings clause. In credit card contracts, federal law prohibits or substantially restricts retroactive application. *Cf.* Alces & Greenfield, *supra* note 93, at 1143–44 (describing how the Credit CARD Act prohibits retroactive changes in the annual percentage rate while giving the creditor limited permission to increase the rate applicable to existing balances when the consumer defaults by being late for more than 60 days).

98. *In re Halliburton Co.*, 80 S.W.3d at 568.

99. *Id.*

100. *Id.*

101. *Id.* at 569–70.

102. *Id.* at 570.

103. *Id.* at 569–70.

Even without any express obligation, courts in other circumstances have attempted to "solve" this issue by imposing certain (implied) obligations, such as the covenant of good faith and fair dealing.[104] In certain areas of contract law, the duty of good faith and fair dealing is expressly required by statute.[105] The primary example comes from the Uniform Commercial Code requirements on output, requirements, and open-price contracts,[106] under which one of the parties has the right to set either the quantity or the price term. The Uniform Commercial Code imposes an obligation to set the price and quantity terms in good faith.[107] Because the duty of good faith is an obligation (or a commitment), this also presumably solves the illusory promise problem. Once the duty is imposed, the party with the unilateral modification right can no longer impose any term that it likes. For instance, if the modified term is unfair to the counter-party (or deals unfairly with the counter party), it will no longer be valid.[108]

2. Unconscionability

The unconscionability doctrine is another line of attack plaintiffs often use against the change-of-terms clauses. If a court finds a contract term unconscionable, the court can strike it from the contract, modify the term, or even declare the entire contract unenforceable.[109] The change-of-terms clause can be subject to unconscionability analysis because one party is given a (much) more favorable deal to the possible detriment of the other. As is well known, to prevail on an unconscionability claim, the plaintiff must show that (1) the term is both procedurally and substantively unconscionable; and (2) the unconscionability was present at the time the term is made.[110] Because the second prong requires a demonstration of unconscionability at the time of the term's creation, some courts have applied the doctrine to resolve the question of whether the presence of a change-of-terms clause at the time of the contract's initial formation would render the contract or the change-of-terms clause itself unconscionable.[111] Others have taken a slightly different

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104. *See* Fagerstrom v. Amazon.com, Inc., 141 F. Supp. 3d 1051, 1066 (S.D. Cal. 2015) (declaring that an arbitration agreement that contained a right of unilateral modification is not illusory because Amazon was bound by the duty of good faith to act within the "common purpose" of the agreement and to the "justified expectations" of the customers).

105. *See supra* note 23 and accompanying text.

106. See U.C.C. § 2-306 (AM. LAW INST. & UNIF. LAW COMM'N 2017) for output and requirements contracts and section 2-305 for open-price contracts.

107. U.C.C. §§ 2-305, 2-306.

108. The idea is similar to imposing the duty of best efforts on an agent in an exclusive agency contract. *See* Wood v. Lucy, Lady Duff-Gordon, 118 N.E. 214, 214–15 (N.Y. 1917). See *infra* Section III.B.4 for more on the implied duty of good faith and fair dealing.

109. *See* U.C.C. § 2-302; RESTATEMENT (SECOND) OF CONTRACTS § 208 (AM. LAW INST. 1981).

110. U.C.C. § 2-302.

111. *See, e.g.*, Flemma v. Halliburton Energy Servs., Inc. 303 P.3d 814, 820–21 (N.M. 2013) (finding an employment contract that contained a change-of-terms clause unconscionable

approach and have been willing to apply the test to the time of modification (and not the initial formation) and to the unilaterally modified term, rather than the change-of-terms clause itself.[112] If this were so, the plaintiff must show that the modification (and not the initial formation of contract) was both procedurally and substantively unconscionable. With respect to the latter, the plaintiff must show that the modified term is unreasonably favorable to the modifying party. This is very much an open question, and the courts will likely grapple with whether the modified term will have an unreasonably favorable effect for the plaintiff. More importantly, the plaintiff will also have to show that the amendment process itself was procedurally unconscionable. In many ways, this inquiry is similar to whether the modification was done in good faith.[113]

3. Interpretation

Courts can also raise the issues of interpretation and ex ante intent with respect to change-of-terms clauses. Basically, when one party grants the other the right to modify the contract, this can raise the question of ex ante intent, such as what degree of discretion did the contracting parties intend and whether the altered term falls within that expectation. *Badie v. Bank of America* illustrates this issue.[114] The case dealt with credit card agreements between the plaintiff-consumers and Bank of America.[115] The original agreement contained a change-of-terms clause which, in relevant parts, stated:

> We May Change or Terminate Any Terms, Conditions, Services or Features of Your Account (Including increasing Your Finance Charges) at Any Time. We May Impose Any Change in Terms on Your Outstanding Balance, as Well as on Subsequent Transactions and Balances. We may also add new terms, conditions, services or features to your Account. To the extent required by law, we will notify you in advance of any change in terms by mailing a notice to you at your address as shown on our records.[116]

because it was unreasonably favorable to the company). *But see* Gillman v. Chase Manhattan Bank, 534 N.E.2d 824, 829 (N.Y. 1988) (finding that a change-of-terms clause in a credit card agreement is not unconscionable because the term was normal in the industry).

112. *See, e.g.*, Powertel, Inc. v. Bexley, 743 So. 2d 570, 574–75 (Fla. Dist. Ct. App. 1999) (stating that the exercise of change-of-terms clause by including an arbitration clause is unconscionable because the clause is added without a bargain, and the counterparty did not have an opt out option, creating an absence of meaningful choice).

113. There are a lot of similarities between the issue of procedural unconscionability and the duty of good faith and fair dealing. Procedural unconscionability principally asks the process question: Did the party in question act in a procedurally fair manner with the counter party? The inquiry is quite similar to asking whether the party has satisfied the fair dealing obligation.

114. Badie v. Bank of Am., 67 Cal. App. 4th 779, 794 (Cal. Ct. App. 1998).

115. *Id.* at 783–84.

116. *Id.* at 786–87 (emphasis omitted).

Subsequent to opening the credit card accounts, Bank of America attempted to insert a mandatory arbitration clause into the agreement by mailing half-page bill stuffers to its customers.[117]

The *Badie* court determined that inserting the mandatory arbitration clause raised an issue of interpretation, in addition to other contract law issues like unconscionability and the implied duty of good faith and fair dealing.[118] Bank of America argued that the change-of-terms provision authorized any modification, but the court disagreed. According to the court, the only "terms" actually included into the original agreement "pertain[ed] to percentage rates for purchases, various fees, the method of computing balance, and the grace period."[119] While the broadly worded change-of-terms clause supported the Bank's interpretation (that they could subsequently add the mandatory arbitration clause), the court reasoned that the plaintiffs' narrow interpretation that the original agreement terms did not include issues of dispute resolution. Between these two possible interpretations of the clause, the court ultimately determined that the plaintiffs' narrower interpretation was more reasonable, and therefore, the Bank could not unilaterally impose a mandatory arbitration clause.[120]

4. Implied Covenant of Good Faith and Fair Dealing

At a very general level, all contracts require the contracting parties to exercise good faith in both performance and enforcement of the contract.[121] Furthermore, the application of good faith usually presumes that there is some discretionary component in the performance of contractual obligations.[122] Based on these principles, the courts will occasionally say that a party has to exercise good faith with respect to the discretion granted under contract.[123] This principle is applicable to the issue of unilateral modification

117. *Id.* at 785.

118. *Id.* at 798.

119. *Id.* at 799.

120. *Id.* at 800–02. According to the court, all the terms that are included in the original contract pertain to "matters that were integral to [the bank/creditor] relationship" and do not discuss other collateral matters, such as the method and forum for dispute resolution, thereby making the banks' interpretation less reasonable. *Id.* at 801.

121. Restatement (Second) of Contracts section 205 states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." RESTATMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981). Official comment *a* refers to the good faith definitions in the Uniform Commercial Code. *Id.* § 205 cmt. a. U.C.C. section 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned" and, with respect to merchants, U.C.C. section 2-103(1)(b) defines good faith to be "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. §§ 1-201(19), 2-103(1)(b) (AM. LAW INST. & UNIF. LAW COMM'N 2017). The comment goes on to state: "The phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context." RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a.

122. *See generally* FARNSWORTH, *supra* note 23, § 4.22.

123. *See generally id.* at 494–500.

because, at least when done expressly, one party is clearly given discretion with respect to modification. The precise contours of what exactly good faith obligation entails is not entirely clear, and there tends to be a substantial amount of overlap when the courts analyze the issue under the implied duty as opposed to other contract law doctrines like illusoriness and procedural unconscionability.

Notwithstanding the uncertainty and substantial amount of doctrinal overlap, at least with respect to unilateral modifications of contracts, case law suggests that the courts seem to require a different combination of (1) a notice provision which obligates the amending party to notify the counterparty about the proposed amendment several days prior and before the amendment becomes effective; (2) a termination or opt-out right, allowing the counterparty to terminate the agreement if she does not agree with the proposed amendment; and (3) a non-retroactive application provision promising not to apply the modified provision to any issues or claims that arose before the modification.[124] If we were to apply all three prongs, the modifying party must, first, give advance notice to the counterparty; second, allow the counterparty to terminate the contractual relationship (or opt out of the proposed modification); and third, make sure that the modified term will not apply retroactively.

IV. CHANGE-OF-TERMS CLAUSE VS. RIGHT TO UNILATERALLY AMEND BYLAWS

Under the current system, unilateral bylaw amendments are facially similar to unilateral contract modifications in a few procedural dimensions. First, with respect to notice, for publicly traded corporations[125] which are subject to federal securities regulation, the directors have an obligation to notify shareholders of the charter and bylaw amendment through an 8-K filing.[126] Because 8-K filings are public, the disclosure of a bylaw amendment through 8-K is arguably more effective than contract modification disclosure

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124. *See, e.g.*, *Badie*, 67 Ca. App. 4th at 779 (applying the implied covenant of good faith and fair dealing principle to unilateral insertion of arbitration clause in credit card agreements). *See generally In re* Halliburton Co., 80 S.W.3d 566 (Tex. 2002) (imposing opt out right and prohibiting retroactive application). There often is a substantial amount of overlap between the court's analysis of other issues, such as illusory promise and unconscionability, and implied duty of good faith and fair dealing.

125. It is unclear what disclosure obligations there are with respect to privately held corporations. In Delaware, there is no statutory obligation to disclose bylaw amendments. Instead, presumably, such obligation is likely to be part of directors' fiduciary obligation to the corporation and its shareholders. This is sometimes called the duty of candor.

126. Securities and Exchange Act § 13 requires firms subject to the federal securities laws to make filings, including periodic reports, with the SEC to keep investors up to date. Securities and Exchange Act of 1934, 15 U.S.C. § 78m(a) (2012). General instructions to Form 8-K, as adopted by the SEC under the Exchange Act § 13, require the reporting firm to file Form 8-K with the SEC. SEC. & EXCH. COMM'N, FORM 8-K, 2 (2017), https://www.sec.gov/about/forms/form8-k.pdf. As one of the events that must be disclosed through an 8-K, Item 5.03(a) includes both charter and bylaw amendments. *Id.* at 17.

through bill stuffers, as is often done in consumer contracts.[127] Second, if shareholders find the bylaw amendment unattractive, they can terminate their relationship with the corporation by selling their stock. Presumably this termination right is strongest for public corporations whose stock is actively traded on a national exchange such as the New York Stock Exchange and NASDAQ. Third, while the case law is not entirely clear, it seems unlikely that the courts will allow directors to apply the amended bylaw retroactively against shareholders, probably as a matter of public policy.[128]

However, even with notification and termination rights, there are important differences which make shareholders' rights substantially weaker. First, unlike contract modifications, notice of bylaw amendments, as required under federal securities laws, is ex post.[129] By the time the notice is given to shareholders, the amendments have already taken place and are effective. Under federal securities regulation, there is no requirement for the directors to notify shareholders of bylaw amendment proposals before the amendments become effective.[130] Second, as other scholars note in charter amendment settings,[131] the presence of an actively trading market, combined with the ex post notification feature, imply that even if a shareholder were to terminate her relationship with the corporation by selling her shares, when the amended bylaw is unattractive for the shareholders, the share price would already be depressed by the time of sale. The damage is already done by the time the shareholder exercises her termination right.[132]

Third, and most importantly, shareholders do not have a meaningful right to opt out or terminate the relationship. Foremost, given that charters and bylaws affect all shareholders, and given the importance of preserving

127. *See supra* note 117 and accompanying text.

128. There is question over what retroactive application means. One possibility is by looking at the timing when the cause of action arose. For instance, if it arose before the company adopted an exclusive forum clause, shareholders should not be subject to the bylaw. This raises the issue of whether the presence of a cause of action creates a "vested right" for the (future) plaintiff. Another, somewhat narrower approach is to look at the time of (constructive) notice of the lawsuit. If, for instance, shareholders file the lawsuit or give notice to the company of their intention to do so before the bylaws are amended, the lawsuit will not be subject to the bylaw. This was the approach used in *Halliburton*. *See supra* note 97.

129. Under Form 8-K instructions, firms must report certain events, including charter and bylaw amendments, within four business days *after* the occurrence of certain events. SEC. & EXCHANGE COMMISSION, *supra* note 126, at 2.

130. *See id.*

131. *See* Bebchuk, *supra* note 25, at 1828; Easterbrook & Fishel, *supra* note 36, at 1443.

132. *See* Bebchuk, *supra* note 25, at 1828. There also is a countervailing element that makes the shareholder's right, vis-à-vis that of a contracting party, more robust. If we assume that the stock price represents the present value of the future "surplus" (e.g., dividends) that the shareholders expect to receive, selling it to a third party allows the shareholder to capitalize the (reduced) surplus. By contrast, when a contracting party terminates the contract, ordinarily, the terminating party does not receive anything, unless stipulated otherwise in the contract, from the counterparty. Tradable stock makes it easier for the shareholder to "terminate" the relationship.

homogeneity, granting individual shareholder (or even individual shares) the right to opt out of amendments would be practically (if not legally) impossible.[133] With respect to the right to terminate, when a shareholder sells her shares after the bylaw amendment, the corporation does not incur a loss because the shareholder will be selling her shares to new investors rather than back to the corporation.[134] By contrast, in a contract setting, when the counterparty terminates the contract either before or after the contract modification, the party that modifies the contract will lose the contractual surplus that the party was expecting to realize in the future. A shareholder selling her shares (through market trading) is akin to a contract party transferring her rights (either through delegation or assignment) to a third party rather than terminating the contract. In a market trading stock, the relationship between a corporation and a shareholder is preserved and only the identity of the shareholders changes. If we are serious about achieving symmetry, shareholders should be able to get their shares redeemed by the corporation. The fact that the corporation does not suffer a loss when a shareholder sells is important for deterrence and incentive reasons. In a contract setting, if a party thinking about modifying the contract is concerned about the other party possibly terminating the contract in response, the party will think twice before going through the modification. On the other hand, if there is no loss of contractual surplus, there could be very little deterrence against self-serving modification.

More generally, the relationship between directors and officers, on the one hand, and shareholders, on the other, is based on the notions of agency. The relationship is more vertical and hierarchical, rather than horizontal or arms-length like the relationship between two contracting parties.[135] Applying

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133. One way of giving differential rights to the shareholders is by creating different classes of stock (Common A, Common B, Preferred A, Preferred B, etc.) and tailoring each class's rights. But, of course, within each class, the same charter and bylaw provisions apply.

134. This is true even when the proposed bylaw amendment destroys value and reduces the share price. By contrast, when a corporation is selling stock with undesirable bylaw provisions, presumably the price that the investors will be willing to pay will decrease, which, in turn, reduces the amount of proceeds that the corporation gets. Therefore, at least in theory, the concerns over opportunistic or self-serving bylaw or charter amendments are greater when done "midstream" (that is, after the corporation has already received the proceeds from sale) rather than at the initial (or secondary) public offering. *See* Coffee, *supra* note 25, at 1574 n.79, 1592; Gordon, *supra* note 25, at 1849–50. At the same time, however, there is doubt as to whether the initial public offering, presumably through its pricing mechanism, can effectively prevent seemingly inefficient charter or bylaw provisions. *See generally* Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J.L. ECON. & ORG. 83 (2001) (documenting how many firms adopt anti-takeover devices at the time of their initial public offering).

135. The relationship does not necessarily fit nicely into the classic agency definition in the sense that the directors and the officers are acting "on behalf of" the corporation and its shareholders but subject to the shareholders' "control." *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006) ("Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the

the notions of agency law, we often think of the shareholders as the de facto or de jure principal and the directors and the managers as the agent who can act on the corporation and shareholders' behalf.[136] This vertical relationship imposes the fiduciary duty on directors and officers, including the duty of care and the duty of loyalty. While directors and officers, as the agents, have the right to manage the business and the affairs of the corporation,[137] they must do so in the corporation and shareholders' best interest. When we take into account that these agents are in charge of managing operations (and the shareholders are prohibited from interfering)[138] and that the shareholders are the residual claimants of the corporation, it follows that allowing the directors and the officers to unilaterally change the governance structures can give rise to the dangers of externality and hold-up.[139]

V. POLICY IMPLICATIONS

What should be the policy objective with respect to charter and bylaw amendments, and, in particular, with respect to unilateral bylaw amendments? We do not argue that just because the courts have applied the contractarian framework to corporate charters and bylaws that we should literally treat them as contracts and subject them to contract law doctrines. At the same time, just as the courts are borrowing the contractual framework conception, we can also examine other contract law principles to better formulate corporate law's approach to charters and bylaws. We also do not argue that unilaterally amended bylaws are always detrimental to the shareholders. Some directors and officers undoubtedly act in the corporations' best interest and attempt to maximize shareholders' returns. They presumably amend bylaws (or make charter or bylaw amendment proposals) that would enhance such interest. At the same time, it is likely not sensible to doubt that there are certain directors and officers whose objective is to maximize their own private benefits and entrench themselves in the

principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.").

136. *Id.* Perhaps, this can justify why the breach of an agent's obligation to the principal can justify stronger remedy, such as disgorgement and punitive damages, while breach of a contractual obligation ordinarily triggers expectation of damages and does not allow the victim to recover punitive damages. *See id.* § 8.01 cmt. d (allowing various remedies, including injunction, forfeiture, and rescissory damages).

137. *See* DEL. CODE ANN. tit. 8, § 141(a) (2018).

138. *See* Hamermesh, *supra* note 49, at 431–32 (explaining that bylaws interfering with the directors' right to manage the corporation under title 8, section 141(a) of the Delaware Code would likely be invalid); *see also* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 235–37 (Del. 2008) (finding conflict between proxy-expense-reimbursement bylaw with title 8, section 141(a) of the Delaware Code and attendant fiduciary duties of the directors).

139. In economic theory, the principal–agent relationship represents a classic example of how one party's (agent's) actions directly affect, i.e., imposes externality on, another's (principal's) welfare.

office.[140] Thus, the first policy objective should be screening: deter charter and bylaw amendments that are harmful to the corporation and detrimental to shareholders while allowing (and promoting) amendments that are beneficial to shareholders.

Furthermore, there is the issue of preserving flexibility. Presumably, one of the reasons why a corporation would want to amend its charter and bylaws (even unilaterally by directors or shareholders) is to make sure that the corporation can effectively respond to new, previously unforeseen circumstances and challenges. This is similar to the reason why contracting parties would either want to modify the contract even though contract performance has not been finished or would want to bestow the right to amend the contract to one of the parties.[141] Particularly with respect to giving directors the right to unilaterally amend bylaws, because going through shareholder voting process is costly and time-consuming, maintaining flexibility can be an important goal. In reference to the aforementioned concerns over possible abuse and managerial opportunism, the policy objective should be to devise a mechanism that will preserve flexibility benefits while prohibiting value-destroying (and self-serving) amendments. In this Part, we proposed and discuss several different possibilities, such as giving the shareholders the right to ask for redemption, mandatory pre-amendment disclosure, more robust voting, and, finally, more active judicial oversight.

A. *Optional Redemption*

Assuming that giving each shareholder or each share an opt out right (so that the amended provision will not apply to the shareholder or the share) is not feasible, one possible mechanism we can consider is to give the shareholders a redemption right so that if they disagree with a proposed amendment, or if it were to affect them adversely,[142] they can sell their shares back to the corporation at a redemption price.[143] The redemption price can

140. The central rationale behind applying heightened judicial scrutiny in hostile takeover cases is based on the concerns about directors' and officers' entrenchment against the interest of shareholders. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

141. The Restatement (Second) of Contracts, for instance, requires that the modification must be done "in view of circumstances not anticipated by the parties when the contract [is] made." RESTATEMENT (SECOND) OF CONTRACTS § 89(a) (AM. LAW INST. 1981). There is some uncertainty as to what "circumstances not anticipated by the parties when the contract is made" means and how strongly courts enforce that "requirement" to the extent that the courts adopt the Restatement's approach. The Uniform Commercial Code, in contrast, does not impose this requirement. *See* U.C.C. § 2-209 (AM. LAW INST. & UNIF. LAW COMM'N 2017).

142. This would be similar to triggering a class voting right when a charter amendment would have an adverse effect on a class of stock. *See supra* note 43 and accompanying text.

143. Stock issued by a Delaware corporation can be made redeemable at the option of the holder. *See* DEL. CODE ANN. tit. 8, § 151(b) (2018) ("Any stock . . . may be made subject to redemption by the corporation at its option or at the option of the holders of such stock or upon the happening of a specified event . . . ."). In fact, in venture capital financing, redemption rights are often granted to preferred shareholders, but the rights get triggered only when certain events,

be set equal to the stock price prevailing before the amendment's announcement to protect shareholders from suffering a loss.[144] This would give the shareholders a bona fide termination right, a right comparable to that of contracting parties. Particularly with respect to bylaws that directors unilaterally adopt or charter amendments that directors and officers opportunistically implement, a de facto termination right can provide a stronger deterrence against the corporate agents. Just like in a contract termination scenario, the corporation will now suffer an actual loss when the value-reducing bylaws or charters are adopted, and the shareholders redeem the shares in response, compared to the case where the shareholders merely sell their shares to others.

However, the problem with this proposal is that the redemption right would potentially make corporate organization less stable and make the corporate form less attractive. There also is the challenge of setting the right redemption price. For instance, if the redemption price is set equal to the stock price prevailing before the amendment or before the proposal's announcement, but the stock price subsequently goes down for unrelated reasons, the drop could lead to a potentially massive capital withdrawal and subsequent liquidity crisis. Given that one of the primary benefits of choosing a corporate form is the capital lock-in and organizational stability, granting shareholders a strong redemption right could substantially reduce that benefit. There also is an issue with the deterrence benefit. When redemption does occur, since the loss is borne directly by the corporation—and indirectly by the remaining, non-redeeming shareholders, and not personally by the directors—the size of the deterrence benefit may also be questionable.[145]

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such as another round of financing or merger, take place. *See* NATIONAL VENTURE CAPITAL ASSOCIATION CHARTER at 33–37. At the same time, title 8, section 160 of the Delaware Code imposes statutory limits on the amount of redemption. DEL. CODE ANN. tit. 8, § 160(a) ("[N]o corporation shall: (1) Purchase or redeem its own shares . . . when the capital of the corporation is impaired or when such purchase or redemption would cause any impairment of capital of the corporation . . . ."). Capital is impaired if the funds used in the repurchase exceeds the amount of the corporation's "surplus," which is defined by title 8, section 154 of the Delaware Code as the excess of net assets over the par value of the corporation's issued stock. *See* SV Inv. Partners, LLC v. ThoughtWorks, Inc., 37 A.3d 205, 210 (Del. 2011) (citing Klang v. Smith's Food & Drug Ctrs., Inc., 702 A.2d 150, 153 (Del. 1997)).

144. Another possibility is to grant shareholders an appraisal remedy, under which dissenting shareholders can demand payment of the "fair value" of their shares. Under the Model Business Corporation Act, with respect to certain charter amendments, shareholders have such a right. *See* MODEL BUS. CORP. ACT §13.02(a) (2016) (AM. BAR ASS'N, revised 2016). However, if the shares are publicly traded, shareholders are no longer entitled to the remedy. *See* MODEL BUS. CORP. ACT § 13.02(b). This is commonly known as the "market out" exception.

145. To the extent that officers' and (possibly) the directors' compensation is tied to stock performance or the market valuation of the company, these corporate agents will also suffer, albeit partially, from any decrease in the stock price.

B. *Mandatory Pre-Amendment Disclosure*

Another possible mechanism is to strengthen the disclosure of the proposed amendment so that the necessary disclosure takes place before, rather than after, the amendment. Such a regime is already in place with respect to charter or bylaw amendments that require shareholder approval.[146] Thus this proposal is more relevant for bylaw amendments that are done unilaterally by directors or a controlling shareholder.[147] The idea is similar to the pre-modification disclosure in contracts.[148] However, in the context of corporations, pre-amendment disclosure will often be ineffective, particularly when there is an active public market for the corporation's stock. With respect to unilaterally amended bylaws, because the proposed bylaw amendment does not require shareholder approval and will certainly become effective in the near future, the stock price will incorporate that information when the proposal is announced.[149] And, even if an existing stockholder were to try to terminate her relationship with the corporation by selling her stock, it is already too late because by then the stock value has already decreased.[150] Unless shareholders can stop the proposed amendment from becoming effective (e.g., by securing an injunction from a willing court, which will require stronger judicial oversight) the share price has already absorbed the amendment's future effects, and the shareholders will suffer a loss.

C. *Shareholder Voting and Approval*

Another possibility is to rely more on the shareholder approval process. Similar to mandatory pre-amendment disclosure, this is not relevant for charter or bylaw amendments that already require shareholder approval and is applicable to unilateral bylaw amendments. Shareholder approval can take a few different forms. The first requires the directors to get the shareholders' express approval (i.e., through voting or written consent) on any proposed bylaw amendment or when a proposed amendment would affect them

146. For instance, under federal securities laws, charter amendment proposals are contained in the proxy for the shareholders' meeting. *See* Min, *supra* note 3, at 296. Even without federal securities regulations, under corporate law, any amendment proposal requiring shareholder approval will have to be circulated to shareholders in advance.

147. For Delaware corporations, shareholders can take any action through a written consent, without holding a meeting and without prior notice. *See* DEL. CODE ANN. tit. 8, § 228. Hence, a controlling shareholder, with more than 50% of the voting power, can unilaterally amend the bylaws through a written consent, without notifying the directors or the minority shareholders.

148. *See supra* Part IV.

149. If there is robust judicial oversight, pre-amendment disclosure can work in tandem with judicial oversight. Upon a corporation's disclosure of the proposed amendment, shareholders can bring suit to enjoin the corporation from implementing the amendment.

150. Even if the stock is not listed on a national exchange or actively traded, presumably, if an existing shareholder wants to sell her stock to a third party, the amount the third party would be willing to pay for would be lower due to the value-destroying amendment.

adversely.[151] If the shareholders are displeased with the proposed amendment, they can simply vote the proposal down. There are, at least, two problems with this form. Foremost, an ex post shareholder vote on all bylaw amendment proposals renders the granting of the right to (unilaterally) amend bylaws to the directors somewhat useless. It turns the bylaw amendment into something more like a charter amendment. Given that there is a distinction between charters and bylaws, and one of the goals of granting directors the right to unilaterally amend bylaws is to preserve flexibility, this proposal would undermine that objective.[152] Furthermore, the proposal imposes a potential for substantial cost and delay. When the directors want to amend the bylaws, they will have to wait until the next shareholders' meeting or convene a special shareholders' meeting to make the amendment effective. For public corporations, given the cost of having to circulate a proxy under federal securities laws this proposal would impose an additional cost on the bylaw amendment process.

A second variation is to strengthen the shareholders' right to undo or amend director-adopted bylaws. Under both the Model Business Corporation Act and Delaware General Corporation Law, regardless of whether shareholders grant directors the power to amend bylaws, the shareholders' right to amend bylaws cannot be restricted.[153] While this is possible, similar concerns arise as in shareholder voting. To modify or repeal the bylaw provision that directors adopted, shareholders will have to circulate a bylaw amendment proposal, convene a meeting (most likely at an annual shareholder meeting for a large publicly traded corporation unless a block holder with sufficient ownership can call a special meeting), and secure a requisite affirmative vote to pass the proposal. This may be quite costly and time-consuming. Furthermore, when the directors' right to amend bylaws is in place, one must wonder whether the directors will promptly undo the shareholders' bylaw amendment. So far, there is no case law that directly deals with this issue.[154]

151. *See* DEL. CODE ANN. tit. 8, § 242(b)(2).

152. As a possible compromise, we could require only that "material" bylaw amendments be submitted to the stockholders for approval. Unless the question of "materiality" is answered through the statute, this can inject a substantial amount of uncertainty.

153. *See* MODEL BUS. CORP. ACT § 10.20(a) (2016) (AM. BAR ASS'N, revised 2016); DEL. CODE ANN. tit. 8, § 109(a). This, of course, is subject to various legal and practical restrictions. See generally Fisch, *supra* note 7, on how the existing legal structure imposes limitations on shareholders' power to amend bylaws, making shareholders' right considerably weaker than that of the directors. What this proposal is advocating for is to broaden or strengthen the rights of shareholders to amend or repeal board-adopted bylaws. *See generally* Smith et al., *supra* note 49 (advocating for giving more rights to the shareholders to adopt and amend bylaws).

154. See *supra* note 49 on this cycling and counter-amendment issue. Another problem of relying on shareholders' repeal is that until repeal has been approved by shareholders, the undesired bylaw remains effective. In contrast, if shareholders were to challenge the validity of a bylaw in court, the court can promptly strike it down.

A third option is to leave the system as is and allow shareholders to hold directors accountable through the director election process. This is the solution the *Boilermakers* court[155] suggests, where the court upheld a forum selection bylaw that the directors unilaterally adopted. Similar to the problem of requiring bylaw amendment proposals to be subject to a shareholder vote, this mechanism will also be costly and time-consuming. In fact, compared to the shareholder voting mechanism, this would be even more costly because the shareholders would likely have to engage in a contested election process.[156] For a public company, in an uncontested election where there is no competing slate of director-nominees, just getting enough votes against the existing directors poses a difficult challenge.[157] Even if the shareholders somehow manage to secure enough votes against the existing directors, because the board of directors usually reserves the right to fill any vacancies, when a director fails to receive sufficient vote to be re-elected[158] the rest of the directors can appoint either the director-nominee who failed to receive the requisite affirmative votes or someone else who will be friendly to their cause. To prevent this problem, the shareholders will have to come up with a competing slate of nominees. Even if there is a block holder (e.g., a hedge fund or an active institutional shareholder) who may be willing to do this, the block holder would be required to wage a potentially costly proxy fight.[159] If there is not a block holder, it is extremely unlikely that any shareholder would be willing to spend the resources to wage a proxy fight. Overall, using director

155. *See generally* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013) (upholding a forum selection clause enacted by the directors).

156. *See generally* Hamermesh, *supra* note 1 (discussing the cost of a director election process).

157. The difficulty of removing directors in an uncontested election is illustrated by the recent experience at Equifax. After the company suffered from a massive data breach where private, sensitive information of about 150 million U.S. consumers were compromised, various institutions, including the Institutional Shareholder Services, Inc., an influential proxy advisory firm, called for a vote against the re-election of the directors, especially the directors who served on the technology committee and failed to adequately oversee the cybersecurity risk. Despite the campaign, in an uncontested election, all of the director-nominees got re-elected. *See* AnnaMaria Andriotis, *Equifax Directors Win Re-Election, Despite Concerns about Breach*, WALL ST. J. (May 3, 2018, 5:50 PM), https://www.wsj.com/articles/equifax-directors-win-re-election-despite-concerns-about-breach-1525384254.

158. *See* DEL. CODE ANN. tit. 8, § 223(a)(1).

159. The recent experience at P&G shows how difficult it may be to remove an existing director in a contested election even when there is an activist hedge fund that is willing to spend a substantial amount of resources in a proxy contest, particularly when a large fraction of the shares are owned by individual, "retail" investors. Trian Fund Management LP, led by an activist Nelson Petlz, waged a proxy fight to replace one director from P&G's board. The costly proxy fight between P&G and Trian reportedly led to a combined estimated expenditure of $60 million. *See* David Benoit, *P&G vs. Nelson Peltz: The Most-Expensive Shareholder War Ever*, WALL ST. J. (Oct. 6, 2017, 6:07 PM), https://www.wsj.com/articles/p-g-vs-nelson-peltz-the-most-expensive-shareholder-war-ever-1507327243. The final tally was vigorously contested and when the dust finally settled, Trian managed to eke out a win by a margin of 0.0016% of the shares outstanding. *See* David Benoit & Sharon Terlep, *Activist Peltz Narrowly Wins P&G Board Seat, New Count Shows*, WALL ST. J. (Nov. 15, 2017, 5:42 PM), https://www.wsj.com/articles/activist-nelson-peltz-elected-to-p-g-board-1510782775.

elections to provide a necessary check on bylaw amendments may be a costly overkill.

Furthermore, under certain circumstances, shareholders may not have any more chance of holding their directors accountable. This is the case when a target corporation is about to be acquired by another corporation and the target directors decide to unilaterally amend the target corporation's bylaws, for instance, by including an exclusive forum or advance notice bylaw.[160] Given that the target corporation will disappear in the near future and all of its directors will resign, there will be no opportunity for the target shareholders to express their disapproval through director election. Although, in theory, they can express their discontent by voting down the merger proposal, when the proposal comes with a premium, voting against the merger proposal would be a risky proposition.

Finally, relying on the shareholder voting mechanism is particularly ineffective if a controlling shareholder or a block holder has adopted a bylaw. When a controlling shareholder, with more than 50% of the voting power, adopts a bylaw through shareholder vote or through written consent, unless the minority shareholders can challenge the bylaw in court, there is no meaningful way for them to repeal or amend it. Also, unlike director elections, there is simply no way for the minority shareholders to remove a controlling shareholder or force the controlling shareholder to divest her interest in the corporation. Even when there is no controlling shareholder with de facto and de jure control, when a bylaw amendment is initiated and supported by a large block holder, such as an activist shareholder with a block ownership, public shareholders may face an uphill battle to repeal or amend the bylaw. Especially due to the recent rise of concentrated ownership, many with dual class stock structure, the concerns over controlling shareholders' possible abuse of power have become more salient.[161]

D. Stronger Judicial Oversight

The final option we consider is to subject charter and bylaw amendments to stronger judicial oversight. This Article argues that given the relatively weak procedural protections given to the shareholders, such as the weak termination and notification rights, a fairly persuasive case can be made for stronger judicial oversight. Stronger judicial oversight can play an effective role, particularly in preserving flexibility while deterring directors' and controlling shareholder's opportunism. Even if any of the structural remedies, such as shareholder voting, has been implemented, active judicial

160. It is not uncommon for the target corporation to amend its bylaw (to include, for instance, an exclusive forum clause) at the same time it announces the merger proposal. *See, e.g.*, TIME WARNER'S 8-K EXHIBIT 3.1 (bylaw amendment), filed on October 22, 2016, *available at* https://www.sec.gov/Archives/edgar/data/1105705/000095015716002366/ex3-1.htm.

161. For a discussion over the recent rise of concentrated ownership in the United States, especially using dual class stock, see Choi, *supra* note 26.

oversight can play an important role in complementing the structural protection. This Part first discusses the existing corporate law doctrine of proper and equitable (reasonable) purpose test and then analyzes the idea of applying the good faith and fair dealing test, borrowed from contract law to charter and bylaw amendments. Lastly, this Part discusses the advantages of imposing stronger judicial oversight.

1. Proper and Equitable Purpose Test

Under the existing corporate law, courts have broad power to declare certain charter or bylaw provisions invalid or to decline to enforce them on a case-by-case basis.[162] Existing case law, especially for bylaws, requires the amendments be done for proper or equitable purpose.[163] If the director-initiated bylaw amendment is deemed improper, inequitable, or unreasonable, shareholders can challenge the bylaw in court. The court can either strike down the entire bylaw provision or deny it on a case-by-case basis. The proper or equitable purpose test has been in Delaware court's arsenal for quite some time, particularly since the seminal cases of *Schnell* and *Frantz Manufacturing*.[164] As noted earlier, Delaware courts have recently seemed to shy away from a robust application of the test, as evidenced by *ATP Tour* and *Boilermakers*.[165] Stronger judicial oversight implies that the courts revive the proper and equitable purpose test to more closely examine the purpose and effect (and the reasonableness) of charter and bylaw amendments, especially those unilaterally adopted.

2. Borrowing from Contract Law Principles

We can also find some ideas from contract law. One approach is to utilize contract law's various interpretation principles. As seen earlier, when construing a change-of-terms clause, courts will attempt to infer the parties' ex ante intent to determine how wide or narrow the directors' discretion is by examining various extrinsic evidence surrounding the time of contract formation (or when the change-of-terms clause was entered into).[166] If necessary, the court adopts a narrower interpretive posture to minimize the potential abuse of discretion and prevent hold-up. Similar interpretation techniques can be applied to charters and bylaws. For instance, if the directors

162. *See, e.g.*, Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (declaring the directors' bylaw amendment invalid). "[I]nequitable action does not become permissible simply because it is legally possible." *Id.* at 439.

163. *See* Choi, *supra* note 1, at 108; EDWARD P. WELCH ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 109.06 (2018); *see also* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 409 (Del. 1985) (upholding bylaw amendments as "not inequitable under the circumstances"); *Schnell*, 285 A.2d at 439–40 (rejecting the directors' bylaw amendment as inequitable).

164. *See generally Frantz*, 501 A.2d 401; *Schnell*, 285 A.2d 437.

165. *See supra* Section II.B.1.

166. *See supra* Section III.B.3.

recommend, and shareholders approve, a certain provision, statements in the proxy or other extrinsic evidence (including how such terms were commercially perceived at the time) can be used to infer the parties' intent.[167] Such a technique can be useful in delineating the discretionary scope of the charter provision granting directors the right to unilaterally amend bylaws. Also, when an amended provision is ambiguous, contract law interpretation techniques can be applied to minimize ambiguity. The interpretation principle of *contra proferentem* can be deployed to interpret the terms against the drafter and to protect the counterparty.[168] By interpreting an ambiguous bylaw term against the directors or the controlling shareholder, who drafted the amendment, the court can better protect the (minority) shareholders from counter-party opportunism.

The court can also employ the implied duty of good faith and fair dealing to charter and bylaw amendments.[169] If the court determines that the amendment is either substantively or procedurally unfair to shareholders (or for that matter to the directors or officers) or that it was done in bad faith, the court can declare the amendment invalid or unenforceable.[170] As noted earlier, under contract law, good faith and fair dealing obligations are understood to include (1) pre-amendment notification; (2) the right to terminate or opt out; and (3) non-retroactive application of the modified terms.[171] Foremost, a persuasive argument can be made that the unilaterally adopted bylaw provision should not be applied retroactively.[172] Additionally, given that the disclosure right, especially for corporations with publicly-traded stock, is ineffective and the termination right is absent, a case can be made

167. *See* Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 927 (Del. 1990) (using statements from the proxy to determine the meaning of the phrase "any similar provision contained in the By-Laws of the corporation").

168. *See* RESTATEMENT (SECOND) OF CONTRACTS § 206 (AM. LAW INST. 1981). For cases in which the Delaware courts have applied the method in interpreting charters and bylaws, see for example, Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 398–99 (Del. 1996), interpreting an ambiguous provision in the certificate of designation against the corporation and in favor of the preferred stockholders; and Aleynikov v. Goldman Sachs Group, Inc., No. 10636-VCL, 2016 WL 3763246, at *6–8 (Del. Ch. July 13, 2016), holding that *contra proferentem* should apply to interpret the word "officer" contained in bylaws against the drafter-corporation.

169. The good faith and fair dealing obligations under contract law are different from the good faith obligation imposed under corporate law. Contract law-based good faith and fair dealing obligations can be imported not as part of the directors' fiduciary duty but because the courts treat charters and bylaws as "contracts" between shareholders and the corporation; *see also* Part I. Also, while the "fair dealing" component seems to invoke the entire fairness test under corporate law, the application of the contract law-based good faith and fair dealing test should not be tantamount to applying the entire (intrinsic) fairness test under corporate law. As a starter, the burden of proof will remain on the plaintiff (rather than on the defendant under the entire fairness test) to show that the directors acted in "bad faith" or did not deal "fairly" when amending bylaws.

170. The test can be applied to the entire clause as a whole (to determine, for instance, its facial validity) or on the application of the clause on a case-by-case basis.

171. *See supra* Section III.B.4.

172. *See supra* note 97 (on "*Halliburton*" savings clause) and accompanying text.

for more proactive judicial review over the substantive terms to test whether they are substantively unfair. This would be akin to strengthening the substantive prong in response to weak procedural protection, an approach that courts have often utilized in contract cases.[173]

3. Benefits of Stronger Judicial Oversight

Compared to the (structural) mechanisms that rely on shareholder voting, the solution of stronger judicial oversight can be deployed without substantial cost or delay. When a shareholder (or a group of shareholders) wants to challenge a charter or a bylaw amendment, she will seek equitable relief to limit its application or undo the amendment. If the court is willing to entertain this argument, the court can decide the (facial) validity issue relatively quickly. This is advantageous because of its speed and low cost. Also, since the shareholders will likely bring the case in a derivative manner or as a direct class action with an attorney incentivized to receive compensation, the mechanism can minimize the collective action problems.[174] Finally, Delaware courts would be quite capable of allowing value-enhancing amendments while preventing self-serving amendments, thus promoting flexibility through case-by-case resolution.

The principles of equitable or proper purpose and good faith and fair dealing will apply equally to unilateral bylaw amendments by shareholders —not just directors. For public corporations with dispersed or passive institutional ownership, shareholders' abusing their unilateral amendment power is quite unlikely. On the other hand, potential shareholder abuse (or opportunism) could be an important concern when a corporation has a controlling shareholder with over 50% of the voting power, or a shareholder

173. See unconscionability cases mentioned in Part III. Judicial review of the substance of the amended bylaw may be particularly important when a controlling shareholder amends the bylaws, through written consent, without notifying the other shareholders or the directors under DGCL section 228.

174. In most derivative actions, plaintiff's attorneys will be entitled to receive compensation from the corporation so long as the outcome of the litigation, either through judgment or settlement, creates a "common fund" or produces a "substantial benefit" to the corporation (and the shareholders). Since nullifying a bylaw will not ordinarily create a common monetary fund, the court will have to declare that it produces a substantial benefit to the corporation (or to the shareholders). This substantial benefit test, properly applied, can also function as a screening mechanism against frivolous lawsuits. *See* Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1 (2015) for more detailed analysis on substantial benefit and common fund doctrines. There are obviously dangers and costs to relying on or inducing more shareholder litigation. But when the courts become more vigilant with respect to whether a "substantial benefit" exists for the corporation and the shareholders, such costs can be more effectively controlled. Recent instances of shareholder litigation in mergers and acquisitions transaction is exemplary. *See* In re Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016). See Choi, *supra* note 1, on how the Delaware legislature and the courts could allow symmetric fee-shifting system to encourage meritorious lawsuits while discouraging non-meritorious ones.

with substantial block ownership, e.g., an activist institutional owner.[175] In either case, a controlling shareholder or a block holder can successfully amend the bylaws to either impede the directors' and officers' right to manage the corporation's business and affairs or to undermine the rights of the minority (or passive) shareholders.[176] If we were to keep the existing framework and preserve the fidelity to the contractarian principle with little judicial oversight, there may be very little that directors or minority shareholders can do to police controlling shareholders' or block-holders' abuse.[177] Through stronger judicial oversight, we can restore the symmetry in deterring abuse by directors and officers on the one hand, and shareholders on the other.

Stronger judicial oversight can also apply to cases where shareholders have approved a proposed bylaw or charter amendment. Under contract law, even for a bilateral modification (a modification that both parties agree to), the court can still declare the modified provision unenforceable. The purpose, under contract law, is to prevent hold-up and abuse of bargaining power.[178] In the context of charter or bylaw amendments putatively approved

175. *See generally* Choi, *supra* note 26 (discussing the hazards of unilateral bylaw amendments by shareholders).

176. *See* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442 (Del. Ch. 2011) (invalidating a reverse stock split bylaw amendment executed by the directors because it favored the controlling shareholder at the expense of minority shareholders); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1077, 1080 (Del. Ch. 2004) (invalidating bylaws enacted by a controlling shareholder that prevented the board "from acting on any matter of significance except by unanimous vote" and "set the board's quorum requirement at 80%" because the bylaws "were clearly adopted for an inequitable purpose and have an inequitable effect."). *But see* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407, 409 (Del. 1985) (validating bylaws adopted by a majority stockholder that increased the board quorum requirement and mandated that all board actions be unanimous. The court found that the "amendments were a permissible part of [the stockholder's] attempt to avoid its disenfranchisement as a majority shareholder and," thus, were "not inequitable under the circumstances."). Recently, National Amusements, Inc., a shareholder that has about 80% of the voting rights over CBS Corporation through ownership of high-vote shares, unilaterally amended CBS's bylaws so as to require super-majority director approval for certain board actions, including declaration of in-kind dividend. CBS Corp. v. Nat'l Amusements, Inc., No. 2018-0342-AGB, 2018 WL 2263385 (Del. Ch. May 17, 2018). This was in response to CBS directors' threat of making pro rata stock distribution to all shareholders of CBS and to eliminate National Amusements' voting control. *Id.* at *4–5. Although the issue of whether National Amusements' unilateral amendment is valid has not been resolved, the Delaware Chancery Court, citing *Frantz Mfg.*, at least recognized a controlling shareholder's right to protect its control position. *Id.* at *6.

177. Especially due to the recent rise of dual class stock with concentrated ownership, this issue has become much more salient. Somewhat interestingly, courts have been more willing to apply the "equitable" or "proper" purpose test to controlling shareholders' unilateral bylaw amendments. *See* Choi, *supra* note 26 (discussing the rise of dual class stock and concentrated ownership). These two lines of cases, one dealing with directors and the other dealing with controlling shareholders, have created a curious asymmetry in case law. One of the arguments of the Article is to harmonize these two lines of cases and also to import (or revive) the "good faith" and "fair dealing" principles. *Id.*

178. *See, e.g.*, Alaska Packers' Assn. v. Domenico, 117 F. 99, 103 (9th Cir. 1902); Lingenfelder v. Wainwright Brewing Co., 15 S.W. 844, 848 (Mo. 1891). Before the adoption of the "fair and

by shareholders, particularly when ownership is dispersed, the collective action and rational apathy problems can prevent shareholders from giving meaningful consent to the proposal.[179] The problem may be more acute with respect to charter amendments, where the directors have the sole power to make an amendment proposal[180] and in cases where there is a controlling shareholder or a blockholder. When the directors or the controlling shareholder (or the block-holder) are vested with the de facto power to set the agenda, knowing that the dispersed shareholders suffer from the collective action and rational apathy problems, can cause them to implement charter or bylaw provisions that are much more favorable to them at the expense of the (minority) shareholders.[181] Such abuses can be deterred through more active judicial monitoring.

Stronger judicial oversight will not operate in vacuum: It will operate together with other policy tools, including director elections and shareholders amending or repealing board-adopted bylaws.[182] To the extent that the shareholders do not have a meaningful termination right, nor an effective pre-amendment notification right, judicial oversight can become an effective check against directorial or controlling shareholder's abuse of power. It will function as a complementary mechanism to the others. Particularly when the directors have the delegated power to amend bylaws, while preserving the flexibility benefits, judicial oversight can mitigate the externality and hold-up problems. Finally, because the judicial oversight mechanism taps into the existing corporate and contract law doctrines, it requires minimal change to the existing legal structure. The proper or equitable purpose test has been part of corporate law for a long time, and one could argue, this is also true of the good faith and fair dealing obligations.[183]

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equitable" test by the Restatement and the "good faith" test by the Uniform Commercial Code, courts used to apply the pre-existing duty rule to safeguard against hold-up and abuse of bargaining power, under which a modification for additional compensation for an existing promise would be held unenforceable. *See generally* FARNSWORTH, *supra* note 23, §§ 4.21–.22.

179. *See* Bebchuk, *supra* note 25, at 1838 (arguing that because the benefits accrue to all shareholders, individual shareholders will underspend in investigating the likely effects of a charter amendment and this will lead to inaccurate pricing of an amendment proposal); Min, *supra* note 3, at 292 (discussing how even institutional shareholders do not necessarily get informed and are incentivized to adopt the recommendations from proxy advisory firms).

180. For examples of "opportunistic" or "preemptive" charter amendment proposals made by the directors and approved by the dispersed shareholders, see Min, *supra* note 3, at 322–26.

181. *See In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG, 2012 WL 729232, at *1–2 (Del. Ch. Mar. 6, 2012) (involving a controlling shareholder attempting to receive a control premium in a merger through a charter amendment by requiring the shareholders to simultaneously vote on the merger and the charter amendment).

182. One of us has argued how utilizing an open-ended standard can better allow contracting parties to police opportunism. *See generally* Albert Choi & George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503 (2008) (looking at how contract design may be used to anticipate adjudication process).

183. *See In re Delphi Financial Grp.*, 2012 WL 729232, at *17 (noting that a charter amendment is subject to the good faith and fair dealing obligations).

By restoring and applying these common law-based doctrines, not only will the contractarian principle be applied in its truest form, but corporate law doctrine can be harmonized with agency law principles.[184]

VI. CONCLUSION

Over the past decade, courts have more willingly applied the theory that the corporate charters and bylaws constitute a contract between the shareholders and the corporations and have upheld a number of bylaw provisions that directors unilaterally adopted. This Article examined this contractarian principle by looking at the comparable issues under contract law. The Article highlighted the fact that the right to unilaterally amend bylaws under corporate law is similar to the change-of-terms clauses under contract law; and, under contract law, the exercise of such discretion is subject to various (statutory and common law) restrictions, including the obligation to act in good faith and deal fairly with the counterparty. Notwithstanding the similarity, when we compare the rights of contracting parties with those of shareholders, the rights of the shareholders are insufficient on one key dimension: the right to terminate the shareholder-corporation relationship. The lack of meaningful termination (or opt out) right, combined with the fact that the relationship between shareholders and directors (and minority shareholders and the controlling shareholder) is more hierarchical rather than horizontal, implies that the shareholders (or the minority shareholders) may be more vulnerable to managerial or controlling shareholders' opportunism.

In considering different mechanisms, the Article has argued that the policy goal should be to mitigate the problems of hold-up and opportunism while preserving the flexibility in amending corporation's organizational documents. With that in mind, the Article has examined various mechanisms, including optional redemption, more robust disclosure rights, shareholder voting, and judicial oversight. After considering the possibilities, the Article suggests that stronger judicial oversight may be better able to achieve the policy goal. By more vigorously applying the proper and equitable purpose test, or by imposing the good faith and fair dealing obligations borrowed from contract law, the Article has argued that the court can better deter both directors' and controlling shareholder's opportunism and guard against collective action and rational apathy problems. At the same time, unlike other costly, time-consuming, or possibly ineffective mechanisms, because courts with expertise can deter opportunistic amendments more quickly and at lower cost, the flexibility desired for shareholders and managers in ordering their private affairs can be better preserved.

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184. *See supra* Section III.A.